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No. ..-...

IN THE

Supreme Court of the United States

October Term, 1982

TIRSO DEL JUNCO, WALTER L. RASIC, ANDRES ALONZO, JR., C.V. HOLDER, MARTIN CASTILLO, GRACE C. QUINN, ANTONIO E. VALLE, GILBERT R. VASQUES, HAL W. BROWN, JR.,

Petitioners,

vs.

C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

PETITION FOR CERTIORARI.

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Petitioners,

vs.

C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

Questions Presented.

1. Whether national bank directors "knowingly violate 12 U.S.C. §84" within the meaning of 12 U.S.C. §93 absent the directors' knowledge that the approved loans exceeded the bank's lending limit.

2. Whether compliance by such directors with *Corsicana National Bank v. Johnson*, 251 U.S. 68 (1919), precludes the Comptroller of the Currency (Comptroller) from preventing them from mitigating their personal liability under 12 U.S.C. §93 for loans which violate 12 U.S.C. §84.

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C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

PETITION FOR CERTIORARI.

Opinions Below.

The opinion of the Court of Appeals, the Comptroller's decision and order to cease and desist and the opinion of the Administrative Law Judge are in the Appendix.

Jurisdictional Statement.

The judgment of the Court of Appeals for the Ninth Circuit was entered on July 30, 1982. The jurisdiction of this Court is invoked under 12 U.S.C. §1818(h)(2) and 28 U.S.C. §1254. Petition for Review for the Comptroller's decision was filed in the Ninth Circuit on July 14, 1981.

Statutory Provisions Involved.

12 U.S.C. §84
12 U.S.C. §93
12 U.S.C. §1818
12 C.F.R. §7.1310(c)(3)
15 U.S.C. §631

The pertinent provisions of the statutes involved are set forth in Appendix F.

Statement of Case.

Petitioners were the directors of Los Angeles National Bank (Bank), a two branch, 35 employee national banking association formed in 1973 pursuant to the National Program for Minority Business Enterprises. (15 U.S.C. §631.) Bank's first president and loan officer was James Carpenter ("Carpenter"). From 1973 until April 1979 Carpenter tutored Petitioners in how to review loans. They had no prior bank managing experience and relied on Carpenter and legal counsel in discharging their duties.

On January 12, 1979 Carpenter recommended to Petitioners (except Grace C. Quinn who was not yet a director)[1] that they approve a loan to Rehbock Lewis (Lewis) in the sum of $225,000. The purpose of the loan was for a reloan by Lewis to Fame Furniture (Fame) of which Lewis was president. Based upon Carpenter's recommendations Petitioners approved the loan.

In April 1979 Carpenter left the Bank, leaving Donald F. Jewett ("Jewett"), who had been with the Bank since 1977, as the Bank's only loan officer.

On May 4, 1979 Jewett recommended that Petitioners approve a $225,000 loan to Fame. Before making his recommendation Jewett determined that the loan did not violate 12 U.S.C. §84 which limits lending to a single borrower

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[1]Petitioner Grace Quinn did not become a director until 1979.

in excess of 10% of the Bank's capital stock. Based on Jewett's recommendation Petitioners (except for Hal W. Brown, Jr.) approved this loan.

On June 14, 1979 Jewett, after determining that there was no violation of Section 84, recommended the approval of a loan of $125,000 to Ralph Ware (Ware). The loan was secured with bonds pledged by Lewis. Ware was Fame's secretary and he reloaned the proceeds to Fame. Based on Jewett's recommendation, Petitioners (except for Antonio E. Valle and Gilbert R. Vasques neither of whom attended the board meeting) approved the loan.

On September 28, 1979 Petitioners were notified by the Comptroller, the Respondent in these proceedings, that the Fame and Ware loans violated Section 84.[2] In the notice Petitioners were directed to reduce the two excess loans to conforming amounts.

This was the first notice by Respondent regarding the violation and the remedial action Petitioners were expected to take. Petitioners immediately commenced collection efforts on the loans.

In December 1979 Respondent conducted his regular periodic examination of the Bank. In his Report of Examination dated February 23, 1980, Respondent again requested Petitioners to either eliminate the excess loans or, as an alternative, deposit in an escrow account funds sufficient to reimburse the Bank for an anticipated $193,000 loss. Petitioners elected to continue their collection efforts to eliminate the excess loans. They did not refuse to take any remedial action requested by Respondent. Petitioners directed that Fame's checking account with the Bank be offset and that the proceeds be applied to pay off the Fame loan.

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[2]Respondent aggregated the two loans pursuant to 12 C.F.R. §7.1310(c)(3) with the Lewis loan to establish the violation.

In June 1980 the Bank sold the collateral securing the Ware loan and applied the proceeds to the loan. As of July 1980 the two "excess loans" were repaid in full. In September 1980 Petitioners, as part of a settlement of a complaint filed by Fame in its bankruptcy proceeding, approved a refund of $47,000 of the offset proceeds. This reinstated an unpaid principal balance of $41,000 on the Fame loan.

While Petitioners' collection efforts were ongoing Respondent commenced administrative proceedings to obtain a cease and desist order. Petitioners answered the notice of charges and an Administrative Law Judge (ALJ) was appointed to hear the case. Respondent moved for summary judgment. (App. B, *infra*, pp. 15-16.)

In their answer Petitioners admitted that when they approved the three loans they knew the proceeds of each loan were to be used for the benefit of Fame. On these admissions in deciding the motion for summary judgment, the ALJ ruled that it was proper for Respondent to aggregate the three loans to find that the Fame and Ware loans violated Section 84.[3] He also ruled that an evidentiary hearing would be required for other issues. After such hearing the ALJ recommended that Respondent issue a cease and desist order, that Petitioners should, after applying the loan recoveries to the two excess loans, indemnify the Bank for the outstanding balance remaining on the Fame loan, and that the Bank recover its loan collection costs and the attorneys' fees it paid for Petitioners' defense. (App. B, *infra*, p. 8.)

Respondent agreed with the ALJ's findings but disagreed with the ALJ allowing Petitioners to reduce their liability by the sums received from their efforts to collect the two excess loans. Respondent's decision and order to cease and

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[3]The Lewis loan did not violate Section 84.

desist declared that Petitioners' liability could not be reduced by recoveries on the excess loans until the Lewis loan, which did not violate Section 84, had been fully repaid with interest. (App. C, *infra*, pp. 41-42; App. D.)

Pursuant to 12 U.S.C. §1818(h)(1) Petitioners timely filed a Petition for Review in the Ninth Circuit (App. E, *infra*), which affirmed Respondent's decision and order to cease and desist. The Circuit found that Petitioners intentionally violated Section 84 because they knew the identity of the borrowers, the loan amounts and the bank's lending limits. It also concluded that Respondent could properly require that before Petitioners reduced their personal liability for the excess loans by recoveries made on them, the legal loan to Lewis must be repaid in full with interest. (App. A, *infra*, pp. 9-10.)

REASONS FOR GRANTING WRIT.

The Circuit's affirmance of Respondent's order in effect approved two rules which conflict with the standard and measure of liability established by this Court for national banking association directors who approve loans which violate Section 84.

Circuit's Interpretation of Intentional Violation Standard of 12 U.S.C. §93 Conflicts With Decisions of Supreme Court.

In 1907 this Court declared that before personal liability may be imposed on a director under Section §93 for damages caused by his violation of the National Bank Act (which includes Section 84), it must be established that the director intentionally or knowingly violated the statute. Mere negligence is not sufficient.

> ". . . [T]he statute imposes certain expressed duties and it makes a knowing violation of such commands the test of civil liability, the oath in this regard also conforms to the requirements of the statute by the promise not to 'knowingly violate, or willingly permit to be violated, any of the provisions of this title' . . . [W]here by law a responsibility is made to arise from the violation of a statute knowingly, proof of something more than negligence is required; that is, that the violation must in effect be intentional. . . ."

[*Yates v. Jones National Bank*, 206 U.S. 158, 178, 180 (1907).]

Again in 1919 this Court stated:

> "Under the rule settled by familiar decisions of this court, in order for the bank to prevail in this action it must appear not only that the liabilities of a person, company, firms, etc., to the bank for money borrowed or permitted to exceed the prescribed limit, but that defendant, while a director, participated in or assented

> to the excessive loan or loans not through mere negligence but knowingly and in effect intentionally . . . with this qualification, that if he deliberately refrained from investigating that which it was his duty to investigate, any resulting violation of this statute must be regarded as 'in effect intentional,' . . . ."

[*Corsicana National Bank v. Johnson*, 251 U.S. 68, 71-72 (1919).]

In applying this standard the Circuit concluded that an intentional violation of Section 84 was established because Petitioners admitted they knew of the amount and stated purpose of each loan. (App. A, *infra*, p. 8.) However, in *Anderson v. Akers*, 9 F.Supp. 151 (D.C. Ky. 1934), a case relied upon by Respondent as explaining the nature of the required knowledge, it was held at pages 152-153:

> ". . . [T]he knowledge necessary to render any particular conduct a violation of any of these statutes . . . is knowledge of the facts constituting that conduct. . . ."

In applying this decision the "facts constituting that conduct" would be knowledge at the time of loan approval that the loan exceeded the bank's lending limits. The validity of this application is borne out by the following decisions where personal liability was imposed only because the directors in fact knew at the time the loans were approved that the loans exceeded the bank's lending limits: *Corsicana National Bank v. Johnson*, *supra*, 71-77 (1919) and *McRoberts v. Spaulding*, 32 F.2d 315 (1929).

These cases require Respondent to prove by substantial evidence that Petitioners when they approved the loans, were aware of the fact that the loans exceeded the bank's lending limits. Respondent did not do so. He relied only on the knowledge that is deemed to exist as a matter of law with regard to every loan approved by a director and to the

only basis for Petitioners' admissions: a director is deemed to know the amount and stated purpose of a loan he approves. If this imputed knowledge satisfies the intentional or knowing violation standard of Section 93, the standard has been replaced by a form of strict liability. Such a concept not only conflicts with the decisions in *Yates* and *Corsicana* and the other cases cited above, it also means the following prediction stated in *Yates* could become a reality:

> ". . . Under such a conception it might well be that prudent and responsible persons would decline to assume . . . the duties imposed by the statute because of the hazard of an uncertain pecuniary liability which the statute imposing the duty did not contemplate. . . ." [*Yates v. Jones National Bank, supra*, 206 U.S. at 179.]

Such a concept when applied to a fast moving and complicated commercial banking world exposes national bank directors to a personal liability that was not contemplated by Section 93 or this Court's interpretations thereof. Petitioners' case exemplifies the problem.

None of the loans in this case individually exceeded the bank's lending limits. Each loan was applied for, presented and considered on a separate, individual basis at different times during a five month period in 1979. This is not a case where Petitioners are simply claiming they did not read or hear as a single figure the total of the loans. Instead, the uncontradicted evidence is that Petitioners at the time they approved each loan believed the loans did not exceed the lending limits of the bank.

Since the intentional violation standard established by *Yates* and *Corsicana* requires something more that what was established by Respondent, a conflict exists between these cases and the Ninth Circuit which justifies the grant of certiorari, especially in light of the impact the outcome will

have on the nature and scope of a national bank director's liability. As far as Petitioners are concerned, the record shows that there was no evidence of Petitioners' knowledge of the fact that the loans in question exceeded the bank's lending limits at the time Petitioners approved the loans. Accordingly, all provisions of the Ninth Circuit's judgment and Respondent's order which impose personal liability on Petitioners or require them to indemnify the bank should be stricken.

Prohibiting Application of Collection Proceeds to Excess Loans Conflicts With Decision of Supreme Court.

The Circuit also held that Respondent's discretion to order Petitioners to take affirmative action to correct conditions resulting from a violation of Section 84,[4] permits Respondent to prohibit Petitioners from reducing their liability for the two excess loans by recoveries on those loans until the Lewis loan is repaid in full. (App. A, *infra*, p. 9.) Such action conflicts with *Corsicana*, 251 U.S. 87, which held that recoveries from borrowers on account of an excess loan would go in diminution of a director's personal liability for that loan.

Respondent refused to follow *Corsicana* in this case:

> "The Directors have cited the *Corsicana National Bank* case for the proposition that recoveries on the illegal loans must be applied to reduce the Directors' liability 'on those loans'. . . . While it is true that the court observed, at 251 U.S. 87, that 'whatever of value the bank recovered from the borrowers on account of the loan would go in diminution of damages' . . ., the observation related to a single loan, not to a series of loans with the first credit extension being legal. In

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[4]12 U.S.C. §1818(b)(1).

other words, this case did not address the question of whether recoveries should be applied to reduce directors' liability on an excess loan while an earlier, lawful loan to the same borrowers remains unpaid." (App. C, *infra*, p. 44, n.5.)

Even though it is well settled that principles of law established by this Court are binding on the Respondent as an administrative agency (*Moore's Federal Practice*, Vol. 18, §0.403 n. 30), a conflict exists between the Ninth Circuit and *Corsicana*, which creates a situation where directors of national banks must now decide which rule to follow in applying recoveries made on excess loans. Their dilemma is acute when: (a) separate loans are made in good faith over a period of time and not as a means of circumventing the bank's lending limits established by Section 84; and (b) collateral is pledged specifically for some of the loans made during that time and not others.

In view of both the number of directors involved in the many national banking associations throughout this country and the complex commercial loan transactions being structured today, this conflict between *Corsicana* and the Ninth Circuit must be resolved so that all directors will know which rule will govern their conduct in similar situations. Unless this occurs, directors relying in good faith on the business judgment rule and advice of the officers and counsel of the bank could easily be penalized for following the long established principle that in the absence of a statute or regulation, their duties and liabilities as bank directors would be regulated by the common law. [*Bowerman v. Hammer*, 250 U.S. 504, 510-511 (1918); *Hoehn v. Crews*, 144 F.2d 665 (1944), *aff'd Garber v. Crews*, 324 U.S. 200 (1944).]

Petitioners, in applying the loan recoveries, complied with the common law according to *Corsicana* and the ob-

ligations created by the standard commercial loan documents executed by the borrowers. At the time they acted there was no regulation or directive from Respondent indicating Petitioners should do otherwise. Respondent did not even announce or raise this new rule regarding the application of recoveries until he filed his post-hearing brief with the ALJ. Until then, Respondent simply directed Petitioners to reduce the two excess loans to conforming amounts. It is true that the Bank's president cautioned Petitioners that applying the recoveries to the two excess loans might be construed as a breach of their fiduciary duties. However, Petitioners had to also consider Respondent's command to reduce the two excess loans and this Court's decision in *Corsicana*. Petitioners elected to follow *Corsicana*.

Respondent in his decision was legislating to limit, distinguish, or eliminate the effect of the common law as set forth in *Corsicana*. As this Court stated in *Union Pac. R. Co. v. Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913), "the first rule of construction is that legislation must be considered as addressed to the future, not to the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be the unequivocal and inflexible import of the terms, and the manifest intention of the legislature." [1 Davis, Administrative Law Treatise §5.09 (1st Ed. 1958).]

In 1978 Congress had the opportunity to eliminate the effect of *Corsicana* when it amended Section 93 by dividing it into sections (a) and (b) and also amended Section 1818. It did not do so. Instead Congress simply gave Respondent some new remedies that were not previously available, such

as the assessment of civil money penalties.[5] Where a statute has been judicially construed for a period of sufficient duration to provide Congress with adequate opportunities to modify the statute and it has not done so, congressional inaction or silence in this context is persuasive evidence of its satisfaction with the judicial interpretation of the statute, especially when Congress has amended the statute in other respects. [*Missouri v. Ross*, 299 U.S. 72, 75 (1936); *United States v. Elgin, J. & E. R. Co.*, 298 U.S. 492, 500 (1935).] As applied in this case, by not changing the original language of Section 93 Congress may be deemed to be satisfied with *Corsicana*.

There is no question that Petitioners as directors were under a fiduciary duty to exercise their powers in good faith and with a view to the interests of the bank. But here, *Corsicana* permitted Petitioners to reduce their personal liability by applying the loan recoveries to the excess loans. No statute enforced or regulation enacted by Respondent told them otherwise. To create and apply an ex post facto rule that requires something quite different from what was required by *Corsicana* is unfair and an abuse of discretion especially when Petitioners' conduct complied with the holding in that case.

As Justice Cardoza once said:

> "What was once settled by a precedent will not be unsettled overnight, for certainty and uniformity are gains not lightly to be sacrificed. Above all this is true when honest men have shaped their conduct on the faith of the pronouncement." (Cardoza, *The Paradoxes of Legal Science*.)

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[5]For the legislative history and purpose of the 1978 amendment of Sections 93 and 1818 see 1978 U.S. Code Cong. and Adm. News p. 9223.

Since Petitioners have complied with *Corsicana*, a case followed by the Courts, Congress, and Respondent since 1919, it is unjustifiable to apply Respondent's new rule retroactively to penalize Petitioners for doing the same thing. Petitioners should be permitted to reduce their liability by the amount of the recoveries on the excess loans, leaving only the unpaid principal balance and accrued interest of the Fame Furniture loan as the extent of their personal liability.

Conclusion.

For these reasons, a writ of certiorari should be issued to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

Counsel of Record for Petitioners:

PATRICK MCADAM,
IVERSON, YOAKUM, PAPIANO
& HATCH.

APPENDIX A.

Opinion.

United States Court of Appeals for the Ninth Circuit.

Tirso del Junco, Walter L. Rasic, Andres Alonzo, Jr., C.V. Holder, Martin Castillo, Grace C. Quinn, Antonio E. Valle, Gilbert R. Vasques, Hal W. Brown, Jr., Petitioners-Appellants, v. C.T. Conover,* Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury, Respondents-Appellees. No. 81-7466.

Filed: July 30, 1982.

Petition for Review of an Order of
the Comptroller of the Currency
Argued and Submitted: May 5, 1982

Before: FLETCHER, PREGERSON and REINHARDT, Circuit Judges. FLETCHER, Circuit Judge:

In December 1979, a periodic examination by the Comptroller of the Currency ("Comptroller") of the Los Angeles National Bank ("Bank") disclosed a possible violation of the provisions of 12 U.S.C. § 84. Section 84 limits the amount that a bank can lend to a single borrower to 10% of the bank's capital stock.[1] At issue was whether three of the Bank's loans were really to the same entity and whether, when added together, they exceeded the bank's legal lending limit.

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*Pursuant to Fed. R. App. P. 43(c), C.T. Conover is substituted for Charles E. Lord as Comptroller of the Currency.

[1] 12 U.S.C. § 84 provides in pertinent part:

> The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund.

The loans were to Rehbock Lewis ("Lewis"), President of Fame Furniture Co., Inc.; Fame Furniture Co., Inc. ("Fame"); and Ralph Ware ("Ware"), Treasurer of Fame. The chart below sets forth the date, borrower, and amount of each loan as well as the legal lending limit of the bank at the time of each loan and the amount by which the loans, when aggregated, exceeded the legal lending limit:[2]

Date Granted	Borrower	Amount	Lending Limit	Excess Amount
9/19/79	Lewis	225,000		
5/9/79	Fame	225,000		
	Subtotal	450,000	272,886	177,134
6/11/79	Ware	125,000		
Present Balance		575,000	277,108	297,892

The legality of the Lewis loan for $225,000 has never been at issue, as that loan did not exceed the legal lending limit of the bank when it was made. However, if the Lewis, Fame, and Ware loans could be aggregated, then the latter two loans would exceed the Bank's lending limit.

The Comptroller first requested the Directors of the Bank to indemnify the Bank for any losses sustained as a result of the two excess loans; the Directors refused. The Comptroller then began a formal cease and desist action against the Directors and the Bank by issuing a Notice of Charges. The Bank and Directors answered, and the Comptroller moved for summary judgment in an agency proceeding.

In the agency proceeding, the Bank and Directors admitted that they knew that the proceeds of the Fame and Lewis loans were to be used for the benefit of Fame. On these facts, the Administrative Law Judge (ALJ) ruled that it was proper to aggregate the Lewis and Fame loans so as

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[2]The amount of the bank's legal lending limit is not an issue in this case.

to constitute a violation of 12 U.S.C. § 84. He also ruled, however, that an evidentiary hearing would be necessary to determine whether the proceeds of the Ware loan were actually used for the benefit of Fame, an element that had to be satisfied if the Ware loan could be added to the Fame loan. Such an evidentiary hearing was then held, and the ALJ determined that the Ware loan was used for the benefit of Fame. Accordingly, the ALJ recommended that the Comptroller issue a cease and desist order, that the Directors indemnify the Bank for the Fame and Ware loans, that the Bank recover costs of collection fees, and that the Bank recover attorneys' fees that it had paid for the Directors' defense.

Although the Comptroller agreed with the ALJ's findings, he disagreed as to the proper construction of section 84 with regard to reducing the Directors' liability. Both the Comptroller and the ALJ agreed that the potential liability of the Directors equalled $350,000, the sum of the two excess loans. The ALJ would have permitted the Directors to reduce their liability of $350,000 by offsetting a checking account of Fame and by selling bonds assigned as security to the Ware loan. The Comptroller, however, concluded that the Directors' potential $350,000 liability could not be reduced by the Bank's recoveries until the legal but unsecured Lewis loan had been fully repaid with interest.[3]

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[3]The Comptroller calculated the Directors' actual liability to the Bank as follows: the Bank had at the time of the hearing collected a total of $332,292 on the total $575,000 line of credit extended for the benefit of Fame. Therefore, for the sole purpose of calculating director liability the Comptroller applied these recoveries first to the reduction of the $225,000 legal loan to Rehbock Lewis. This left $107,292 to be applied to the reduction of the Directors' potential $350,000 liability on the two illegal Fame-related loans. Thus the Comptroller determined that the Directors were liable to the Bank in the principal amount of $242,708. The Comptroller also found that the Directors were liable for interest lost by the Bank on the two illegal loans in the amount of $71,598.56.

(footnote continued on following page)

The Directors then moved this Court to stay the Comptroller's final judgment. This court denied the motion without prejudice. Next, the Directors filed an identical motion with the Comptroller, who denied the motion. The Directors now appeal the final judgment of the Comptroller.

ISSUES

1. What is the proper standard for reviewing the Comptroller's fashioning of a remedy?
2. Did substantial evidence support the Comptroller's finding that the proceeds of the loan made by the Bank to Ware were used for the benefit of Fame in violation of the lending limit imposed by 12 U.S.C. §84?
3. Were the remedial measures required by the Comptroller appropriate to correct conditions resulting from the Directors' violation of 12 U.S.C. § 84?

I. STANDARD OF REVIEW.

The parties agree that a "substantial evidence" standard applies to judicial review of administrative findings. The parties are correct. *See* 5 U.S.C. § 706(2)(E).

The Comptroller has broad discretion to fashion a remedy. *See Groos National Bank v. Comptroller of Currency*, 573 F.2d 889, 897 (5th Cir. 1978). "Substantial evidence is required for the Comptroller's findings, but once the Comptroller finds a violation he may, within his allowable discretion, fashion relief in such a form as to prevent future abuses." *Id.* Similarly, he has broad discretion to cure the effect of a violation.

Consequently, the Comptroller calculated the Directors' actual total liability to the Bank to be equal to $314,306. The Comptroller also held that once the Directors have indemnified the Bank for this amount, the Directors and not the Bank are to receive the benefit of any additional recoveries made on the Fame-related loans. In order to effectuate this result, Article III of the Comptroller's order to cease and desist requires the Bank to transfer all remaining interest or rights that it may have in the Fame-related loans to the Directors after such time as the Directors have complied with Article II's indemnification requirement.

In reviewing the order that actually issued, we consider whether the affirmative action taken by the Comptroller was appropriate to correct the condition resulting from the Directors' violation of the banking laws.[4]

II. THE COMPTROLLER'S FINDING IS SUPPORTED BY SUBSTANTIAL EVIDENCE THAT THE PROCEEDS OF THE LOAN MADE BY THE BANK TO WARE WERE USED FOR THE BENEFIT OF FAME IN VIOLATION OF THE LENDING LIMIT OF 12 U.S.C. § 84.

The regulation that implements the lending statute provides that "[o]bligations of a corporation must be combined with any other extension of credit *the proceeds of which are used for the benefit of the corporation.*" 12 C.F.R. § 7.1310(c)(3) (1981) (emphasis added). The issue presented by this regulation is whether there was substantial evidence to support a finding that the $125,000 loan to Ware, the Treasurer of Fame, was "used for the benefit of the corporation."

The Comptroller found:

> The hearing record clearly discloses the purpose and use of proceeds of the Ware loan. Mr. Ware, Fame's treasurer, testified that Fame's checking account at another bank was overdrawn. Accordingly, he and Mr. Lewis, Fame's president, went to the Bank to procure another loan. The Bank's vice president and senior

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[4]The statutory grant of authority that allows the Comptroller to issue an order to cease and desist from a violation or practice states in part:

> Such order may, by provisions which may be mandatory or otherwise, require the bank or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

12 U.S.C. § 1818(b)(1).

lending officer, Mr. Jewett, informed Lewis and Ware that the Bank could not make an additional loan to Fame or to Mr. Lewis without violating the Bank's legal lending limit. Therefore, Mr. Ware's "name was used for the loan papers to borrow the money." Hearing Transcript 50-51. As agreed, the Bank put the Ware loan proceeds directly into Fame's corporate checking account. Hearing Transcript 51-52. See also Hearing Transcript 179-80, wherein Mr. Jewett testified that he knew the proceeds were "going to go through Mr. Ware to Fame." On these facts, the Comptroller agrees with the ALJ's finding and conclusion that the deposit of the Ware loan proceeds directly into Fame's corporate checking account shows that the proceeds were used for the benefit of Fame.

The evidence of the corporation's overdrawn account, the corporation's search for another loan, the action and knowledge of the Bank's lending officer, and the deposit of the loan proceeds directly into Fame's account is substantial enough to support the Comptroller's finding.

Thus, because sufficent evidence supported the finding that the Ware loan was for the benefit of Fame, that loan could be aggregated with other Fame loans to calculate whether an excess loan had been made.

III. THE REMEDIAL MEASURES REQUIRED BY THE COMPTROLLER WERE APPROPRIATE TO CORRECT CONDITIONS RESULTING FROM THE DIRECTORS' VIOLATION OF 11 U.S.C. § 84.

The Directors attack the remedy sought by the Comptroller in Article II of the cease and desist order.[5] The Directors argue that (a) indemnification is an improper remedy

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[5]The provisions of Article II are summarized: (1) The Directors, with some exceptions, must indemnify the Bank for lost principal and interest on the Fame and Ware loans; (2) The Directors must indemnify the Bank for attorneys' fees; (3) The Directors must indemnify the Bank for its efforts to collect the Fame and Ware loans.

because the Directors did not "knowingly violate" the banking laws; (b) if indemnification is a proper remedy, then the Directors must be allowed to reduce their liability on the illegal loans by offsetting a checking account and selling collateral, even though the legal unsecured loan remains unpaid; (c) the Comptroller lacks authority to order that collection and attorneys' fees be paid to the Bank.

A. The Directors Knowingly Violated the Lending Requirements of 12 U.S.C. § 84.

In the past, violations of the excess lending rule in 12 U.S.C. § 84 (1976) have been enforced through district court proceedings made possible by 12 U.S.C. § 93 (1976 & Supp. IV 1980). Section 93, which is derived from the National Bank Act of 1864, imposes liability on directors for knowingly violating or knowingly permitting violations of the banking laws. Here, however, the Comptroller, in an enforcement proceeding, is seeking to indemnify the Bank through the application of 12 U.S.C. § 1818(b)(1) (Supp. IV 1980).[6] Although in effect since 1950, section 1818(b)(1) was significantly amended in 1978 to extend the coverage of cease and desist orders, which had previously applied only to a bank, to include a bank's directors. On its face, § 1818(b)(1) requires no knowledge on the part of the wrongdoer. The provision simply allows the Comptroller "to take affirmative action to correct the conditions resulting from any such violation or practice."

Defendants argue, however, that 12 U.S.C. § 1818(b) imports the scienter requirement of § 93 when the Comptroller seeks to impose personal liability on bank directors for exceeding bank lending limits. We need not and do not resolve that question today. Even if the "knowingly" stan-

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[6] *See* note 4, *supra*.

dard of 12 U.S.C. § 93 applies to an 1818(b) enforcement proceeding, we agree with the Comptroller that defendants are liable here.

The Supreme Court has enunciated the scienter requirement of § 93:

> Under the rule settled by familiar decisions of this court, in order for the Bank to prevail in this action it must appear not only that the liabilities of a person, company, firms, etc., to the Bank for money borrowed were permitted to exceed the prescribed limit, but that defendant, while a director, participated in or assented to the excessive loan or loans not through mere negligence but knowingly and in effect intentionally . . . with this qualification, that if he deliberately refrained from investigating that which it was his duty to investigate, any resulting violation of the statute must be regarded as "in effect intentional," . . . .

Corsicana National Bank v. Johnson, 251 U.S. 68, 71-72 (1919) (citations omitted).

The Directors had knowledge of the identity of the borrowers, knowledge that all the loan proceeds were to be used by one company, and knowledge of the loan amounts and the bank's loan limits. The defendants have maintained that, because the loans were made on separate occasions, they failed to aggregate the loans. However, 12 U.S.C § 84 requires the aggregation of loans to a single entity. Directors of a national bank operate in an area closely regulated by federal law, and cannot maintain ignorance of the law as a defense.[7] *Cf. United States v. Corbin Farm Service*, 444 F. Supp. 510, 519 (E.D. Cal.), *aff'd* 578 F.2d 259 (9th Cir. 1978) (word "knowingly" in penalty section of federal

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[7]Indeed, defendants concede in their opening brief: "Appellants' [sic] are not claiming ignorance of the law as a defense."

pesticides act refers to awareness of facts, not awareness of law).

Since the scienter requirement of § 93 has been satisfied, whatever requirement § 1818(b) may have imported from § 93 has also been satisfied.

B. The Comptroller Can Properly Require that the Directors' Potential Liability of $350,000 Not Be Reduced by Recoveries Until the Legal Loan to Lewis has been Repaid with Interest.

The Directors' potential liability is limited to $350,000—the difference between the total credit extension to Fame ($575,000) and the amount of the legal Lewis loan ($255,000).[8] The Comptroller takes the position that the Directors' potential loss of $350,000 cannot be reduced by recoveries until the legal loan to Lewis has been repaid with interest.

In the instant case, the purpose underlying 12 U.S.C. § 84—protection of a bank's assets—will be furthered if the Directors are not allowed to extinguish their liability until the legal Lewis loan, which is unsecured, is fully repaid.[9] The policy of protecting bank assets would be frustrated if the Directors were allowed to make, as they did,

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[8]The Directors argue that their liability should be reduced as the Fame and Ware loans are extinguished. The Ware loan has been extinguished by the sale of bonds held as collateral and the Fame loan has been reduced by the offset of Fame's checking account. The Comptroller concedes that, as to the relationship betwee the Bank and the borrower, collateral can be used to reduce only the loan to which the collateral was assigned. However, the Comptroller reasons that the legal principles governing offsets and the sale of collateral to pay off a loan need not apply to the relation between the Bank and its Directors in determining the Directors' liability.

[9]The initial Loan Credit Report stated that the Lewis loan was to be secured "from receivables of Co. and/or sale of bonds." The bonds were actually used, however, to secure the illegal Ware loan rather than the legal Lewis loan.

an unsecured but legal loan to the borrower, then to use, or agree to the use of, the borrower's assets to secure further credit extensions that are illegal. Such a procedure would permit the Directors to protect themselves fully against any exposure resulting from the illegal loans while substantially increasing the risk that the bank would be unable to recover the amount of its legal loan. The fiduciary responsibility of the Directors of the bank precludes them from protecting themselves against liability at the bank's expense. The security arrangement was in derogation of that responsibility. Thus, the Directors may not use the borrower's assets to extinguish their own liability to the bank.

Here, the Directors ignored the recommendation of the Comptroller and the bank president's advice that the first loan to be paid off should be that of Rehbock Lewis and not Fame Furniture, since the stockholders might claim that this loan was paid to limit the liabilities of the Directors. The Comptroller's remedy is appropriate, because any other remedy could create a conflict of interest between the Bank and its Directors.

In light of the Comptroller's broad discretion to fashion an appropriate remedy, we conclude that the remedy he selected was lawful. It serves to protect the bank's assets, to insure that the Directors fulfill their fiduciary duty, and to prevent the Directors from insuring themselves against liability for their wrongful act at the Bank's expense.

C. The Remedy for Correcting Conditions Resulting from the Directors' Violation of Section 84 Properly Includes Collection Expenses on the Illegal Loans and Attorneys' Fees Paid by the Bank on Behalf of the Directors.

The Directors argue that the Comptroller is not authorized to award the Bank collection expenses and attorneys' fees paid by the Bank on behalf of the Directors. The Comptroller

responds that he is authorized by 12 U.S.C. § 1818(b)(1) to take affirmative action to correct conditions resulting from the Directors' violation of the banking laws. Obviously the Comptroller has interpreted the Bank's collection expenses and attorneys' fees paid on behalf of the Directors as "conditions resulting" from the violation of 12 U.S.C. § 84.

The Directors argue that the collection expenses are not a condition resulting from the violation of the law: "There is no evidence that but for these loans being excessive they would not have become delinquent." That argument is meritless. If the Directors had acted within the law, the excess loans would never have been made, and the problem of collection would never have arisen.

The Directors also argue, relying on *Greene County Planning Board v. Federal Power Commission*, 455 F.2d 412 (2d Cir.), *cert. denied*, 409 U.S. 849 (1972), that the Comptroller lacks authorization to grant attorneys' fees absent a specific congressional mandate to do so. *Greene*, however, dealt with the power of a district court to grant attorneys' fees to third-party intervenors who sued under the National Environmental Policy Act and demanded attorneys' fees. While the power of the court to grant attorneys' fees to private parties in a suit is carefully circumscribed, that situation is entirely different from the one at bar. In the instant case, the Bank is not a third-party intervenor and is not demanding attorneys' fees. It is the Comptroller who has ordered the award to make the Bank whole for losses resulting from the Directors' violation of the banking laws. Deference is due to the Comptroller's interpretation of the law under which he operates, and he has interpreted "affirmative action to correct conditions resulting" from the Directors' violation of 12 U.S.C. § 84 to cover an award of attorneys' fees.

CONCLUSION

The Comptroller's decision and final order to cease and desist are affirmed. Substantial evidence supported the Comptroller's finding that the three loans could be aggregated as loans to a single business. Furthermore, the Comptroller, in fashioning a remedy, acted within the scope of his authority to correct conditions resulting from the Directors' violation of the banking laws.

APPENDIX B.

Opinion and Recommended Decision, Findings and Conclusions of Administrative Law Judge.

United States of America, Department of the Treasury, Office of the Comptroller of the Currency.

In the Matter of Los Angeles National Bank, Los Angeles, California. AA-EC-80-9.

FRANCIS L. YOUNG, Administrative Law Judge.

Appearances:

HOWARD N. CAYNE, ESQ.
ROBERT S. PASLEY, ESQ.
for the Comptroller.

NEIL PAPIANO, ESQ.
PATRICK McADAM, ESQ.
for the Directors.

LEONARD M. AMATO, ESQ.
for the Bank.

Dated: March 4, 1981.

INTRODUCTION.

On May 22, 1980 Counsel to the Comptroller of the Currency personally served on the Los Angeles National Bank (hereinafter Bank) and the individual members of its Board of Directors (Directors) a Notice Of Charges and a Temporary Order To Cease And Desist.

The Notice Of Charges gave notice that a hearing pursuant to the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. § 1818(b)) would be commenced at a specified time and place in Los Angeles, California to determine whether an Order To Cease And Desist should be issued. The Notice then set out a series of allegations in six sections or articles, designated Article I through Ar-

ticle VI. Article II alleged that the Bank had made certain extensions of credit in excess of the Bank's legal lending limit, and that these extensions had been knowingly approved and permitted by the individual Directors. Other articles alleged a number of other unlawful actions or failures to act on the part of the Bank and its individual Directors.

The Temporary Order To Cease And Desist stated that the Comptroller had determined that the violations or threatened violations of law or the unsafe and unsound practices specified in the Notice Of Charges, or the continuation thereof, were likely to cause insolvency or substantial dissipation of the assets or earnings of the Bank or were likely seriously to weaken the condition of the Bank or otherwise seriously prejudice the interests of its depositors. As a consequence, by virtue of the 12 U.S.C. § 1818(c)(1), the Comptroller ordered that certain immediate steps be taken by the Bank pending completion of administrative proceedings pursuant to the Notice Of Charges.

The Notice Of Charges directed that the Bank and the individual Directors answer the charges, specifying that the Directors should respond to the allegations in Article II, paragraphs 5 and 6, and that the Bank should respond to all of the other allegations. Such answers were duly filed.

Counsel for the Comptroller filed a Motion For a More Definite Answer, asking that the individual Directors be required to file a more definite answer to the allegations in Article II, paragraph 5 of the Notice Of Charges. A telephone conference was conducted by the administrative law judge with counsel for the Comptroller and counsel for the Bank and Directors participating. As a result of this conference, the judge issued an order dated June 27, 1980

setting out an amended Article II and requiring the Directors to file an answer to it.[1]

A hearing date having been set, the administrative law judge directed the parties to make various prehearing filings with respect to witnesses, expected testimony, documentary exhibits, and the like. After these filings were made, and as the hearing date approached, counsel for the Comptroller moved on July 2, 1980 that the hearing be continued so that he could file a motion for a recommended decision on the pleadings. A continuance was granted in an order of the administrative law judge dated July 3, 1980 which also provided that government counsel should file another amended paragraph 5 of the Notice Of Charges, provided time for the Directors to file an answer to it, and directed that thereafter counsel for the Comptroller would either file his motion for a recommended decision on the pleadings or request that the matter be reset for hearing. Counsel for the Comptroller on July 9, 1980 filed his Amended Notice Of Charges with respect to Article II, paragraph 5, and the Directors in due course filed their answer to it.

Meanwhile, the administrative law judge, as a result of his study of the pleadings and developments in the case, became concerned that there might be conflicting interests between the Bank on the one hand, and its individual Directors on the other, and requested counsel for the Comptroller and counsel who had until then been representing the Bank and its Directors to file memoranda with respect to whether or not an order should be entered prohibiting the Bank and the Directors from being represented by the same counsel. These memoranda were filed and carefully considered by the judge who thereafter, in a Memorandum And

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[1]This order was amended to correct a minor typographical error by another order dated July 1, 1980.

Order dated July 17, 1980 prohibited the attorneys who had thus far been representing the Bank and its individual Directors from further representation of the Bank in this matter. Subsequently, separate counsel entered his appearance for the Bank. Counsel who had been representing the Bank and the Directors thereafter represented only the Directors.

As the result of a telephone conference on July 23, 1980, counsel for the Directors submitted a request for admission of certain stated facts considered relevant by the Directors with respect to the subject matter of the allegations in the Comptroller's Amended Article II paragraph 5, and a response was filed by counsel for the Comptroller. Counsel for the Comptroller then also filed a motion in the nature of a motion for summary judgment, contending that as a result of the answers to the charges and of the request for admissions and the response thereto, it was unnecessary to hold an evidentiary hearing, and that the administrative law judge could make his recommendations to the Comptroller without receiving any further evidence.

After the filing of this motion but before responses were filed by the other parties, a telephone conference was held on September 30, 1980. Counsel for the Comptroller stated that he would dismiss the allegations of wrongdoing contained in Article III, IV, V and VI of the Notice Of Charges, and that he would continue to press only the allegations in Article II, paragraphs 5 and 6, as amended.

After the Directors filed points and authorities opposing the Comptroller's summary judgment motion, the administrative law judge, in a Memorandum To Counsel dated October 17, 1980, ruled that certain of the factual issues presented in Article II, paragraphs 5 and 6 of the Notice had been resolved by various filings in the record, but that certain other factual issues remained which would require the taking of evidence. A further prehearing telephone con-

ference was conducted on October 21, 1980, a Prehearing Ruling was issued, and the hearing commenced in Los Angeles on November 5, 1980. It concluded in the late afternoon of the following day.

After the hearing, at the behest of the administrative law judge, filings were made by counsel for the Directors and for the Comptroller with respect to whether or not a further hearing session should be convened for the purpose of receiving evidence with respect to the term "minority bank." The Directors were asserting that there had been a Federal program to encourage the establishment of "minority banks" in response to which Los Angeles National Bank was established to serve the interests and needs of a minority, and that special consideration should be given to the Directors of that Bank as a consequence. After careful consideration of the papers filed, the administrative law judge concluded that it would not be appropriate to convene a further hearing session stating, in a Memorandum To Counsel dated December 19, 1980: "that any issue with respect to Respondent Bank's being 'a minority bank' should have been raised before the hearing was conducted in Los Angeles on November 5th and 6th 1980 and that any evidence which the Directors wished to place before the administrative law judge and the Comptroller in that connection should have been proffered at that hearing."

Thereafter counsel for the Comptroller and for the Directors submitted proposed findings of fact and conclusions of law and briefs, as well as reply briefs. No post hearing has been made by counsel for the Bank.

The administrative law judge has carefully considered all of the points and arguments raised by the parties. The findings of fact made by the administrative law judge are included in the discussion which follows. In arriving at his findings and conclusions the administrative law judge has

applied the preponderance of the evidence standard. *Steadman v. SEC* (1981) ___ U.S. ___ (Case No. 79-1266, decided February 25, 1981).

DISCUSSION AND FINDINGS

I

Violations By The Bank

As finally amended, the Notice Of Charges alleges violation by the Bank and the Directors only of section 84 of title 12 U.S.C. The Notice proposes the imposition of sanctions pursuant to 12 U.S.C. § 1818(b).

Section 84 provides in pertinent part:

> The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. * * *

The Notice Of Charges, by incorporating a portion of a Report Of Examination, detailed the alleged violations of this code section as follows:

> The following loans are combinable and subject to the limits of 12 U.S.C. 84, as all funds were used by Fame Furniture Co., Inc. for business purposes, and the source of repayment is business income of Fame Furniture Co., Inc.

Date Granted	Borrower	Amount	Lending Limit	Excess Amount
1-19-79	Rehbock Lewis	225,000		
5-9-79	Fame Furniture Co., Inc.	225,000		
	Subtotal	450,000	272,866	177,134
6-11-79	Ralph Ware	125,000		
	Present Balance	575,000	277,108	297,892

Section 1818(b) is captioned "Cease-and-desist proceedings" and provides in pertinent part:

> (b)(1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any director, * * * or other person participating in the conduct of the affairs of such a bank is engaging or has engaged, * * * in an unsafe or unsound practice in conducting the business of such bank or is violating or has violated, * * * a law, rule, or regulation, * * * the agency may issue and serve upon the bank or such director, * * * a notice of charges * * *. The notice shall contain a statement of the facts * * * and shall fix a time and place at which a hearing will be held * * *. [I]f upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director, * * * an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory * * *, require the bank or its directors, * * * to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

In its Answer the Bank admitted that it is subject to these statutory provisions, and that it had extended credit for the benefit of Fame Furniture Company, Inc., in an amount exceeding its legal lending limit established by the provisions of 12 U.S.C. § 84. The record clearly establishes the loans or credit extensions, and legal lending limits, as specified above. The administrative law judge finds and concludes that a "cease and desist" order may lawfully be issued and served on the Bank.

II

Violations By The Directors

With respect to the Directors, the Amended Notice Of Charges alleges:

(5)(a) On January 19, 1979, the BANK made a $225,000 credit extension in the name of Rehbock Lewis, President of the Fame Furniture Company, Inc. (FAME), the proceeds of which were used for the benefit of Fame. The Board of Directors approved of and permitted this credit extension with knowledge of its purpose and amount.

(b) On May 9, 1979, the BANK extended credit to FAME in the amount of $225,000. The Board of Directors approved of and permitted this credit extension with knowledge of its purpose and amount.

(c) On June 11, 1979, the BANK made a $125,000 credit extension in the name of Ralph Ware, Treasurer and Assistant Secretary of FAME, the proceeds of which were used for the benefit of FAME. The Board of Directors approved of and permitted this credit extension with knowledge of its purpose and amount.

(d) The BANK's legal lending limit as established by 12 U.S.C. § 84 was $272,866 on May 9, 1979 and $277,108 on June 11, 1979.

(e) As of May 9, 1979, no reductions in principal had been made on the credit extension alleged in paragraph (5)(a) above.

(f) As of June 11, 1979, no reductions in principal had been made on the credit extensions alleged in paragraphs (5)(a) and (5)(b) above.

(g) The Board approved the credit extensions alleged in paragraphs (5)(b) and (5)(c) in violation of 12 U.S.C. § 84.

In their Answer filed with the administrative law judge on July 21, 1980 the Directors "separating themselves from each other, individually answer[ed]" as follows:

(5)(a) Admits that on or about January 19, 1979, the BANK made a $225,000 credit extension in the name of Rehbock Lewis, President of the Fame Furniture Company, Inc. (FAME), the proceeds of which were used for the benefit of FAME; and the Board of Directors approved this credit extension with knowledge that the principal amount of the credit extension was $225,000 and that the proceeds would be reloaned to FAME by Mr. Lewis. Except as expressly admitted, each of the Directors denies the allegations of Paragraph (5)(a).

(b) Admits that on May 9, 1979, the BANK extended credit to FAME in the amount of $225,000; and the Board of Directors approved this credit extension with knowledge that the principal amount of the credit extension was $225,000 and that the proceeds were used for the benefit of FAME. Except as expressly admitted, each of the Directors denies the allegations of Paragraph (5)(b) and specifically denies that the credit extension was made with the knowledge that it violated the BANK's legal lending limit or 12 U.S.C. § 84 or that any such information or knowledge was brought to the attention of the Directors of any of them.

(c) Admits that on June 11, 1979, the Bank made a $125,000 credit extension to Ralph Ware, the proceeds of which would be reloaned to FAME by Mr. Ware and that the Board of Directors approved this credit extension with knowledge that the principal amount of the credit extension was $125,000 and that the proceeds were to be reloaned to FAME by Mr. Ware. Except as expressly admitted, each of the Directors denies the allegations of Paragraph (5)(c) and specifically denies that the credit extension was made

with the knowledge that it violated the BANK's legal lending limit or 12 U.S.C. § 84 or that any such information or knowledge was brought to the attention of the Directors or any of them.

(d) Admits that the BANK's legal lending limit as established by 12 U.S.C. § 84 was $272,866 on May 9, 1979 and $277,108 on June 11, 1979.

(e) As of May 9, 1979, no reductions in principal had been made on the credit extension alleged in paragraph (5)(a) above.

(f) As of June 11, 1979, no reductions in principal had been made on the credit extensions alleged in paragraphs (5)(a) and (5)(b) above.

(g) Admits that the credit extensions alleged in paragraphs (5)(b) and (5)(c) would violate 12 U.S.C. § 84 if they were aggregated as a legal matter as alleged by the Comptroller. Except as expressly admitted, each of the Directors denies the allegations contained in (5)(g) and specifically denies that said credit extensions were made with the knowledge that either one or both violated the BANK's legal lending limits or 12 U.S.C. § 84.

Thus the record clearly established that the Directors approved each of the three subject credit extensions with knowledge that the proceeds were intended to be used for the benefit of Fame. The record clearly establishes also that the three credit extensions were made by the Bank.

The principal controversy in the case revolves around whether or not on these facts the Directors can be found to have violated Section 84.

A regulation issued by the Comptroller, 12 C.F.R. § 7.1310(c)(3), provides:

> "Obligations of a corporation must be combined with any other extension of credit the proceeds of which are used for the benefit of the corporation."

The Office of the Comptroller (OCC) contends that the three subject credit extensions, to Mr. Lewis, Fame itself, and Mr. Ware, must be aggregated with the result that the second and third constituted violations of Section 84. Since the Directors approved each extension with knowledge of the amount, recipient and purpose of each, they have violated Section 84, says the OCC, and are subject to the penalties provided by Section 1818(b).

The Directors admit that they knew these facts, including the purpose, with respect to each of the three individual credit extensions. But, they point out, no one of the loans or extensions exceeded the legal lending limit. They say that it never occurred to them that the Comptroller would aggregate the three transactions. They contend that, accordingly, they did not knowingly violate Section 84 and therefore they are not liable under Section 1818(b).

The OCC responds by saying that the Directors knew the facts. They knew, or should have known, the law. Therefore they are liable, whether they were conscious of violating the law or not.

The administrative law judge concludes that the OCC is correct. It is hornbook law that ignorance of the law is no defense. The Directors knew the facts. They acted. Such action was in violation of Section 84. Therefore, they are liable pursuant to Section 1818(b).

The Directors cite Section 93 of Title 12, which fastens certain liabilities on bank directors who "shall knowingly violate" certain provisions of law, including Section 84. This present proceeding, however, is not brought pursuant to Section 93. Section 93 provides for the bringing of an action against directors in a United States District Court. It appears to have been enacted long before Section 1818(b) which authorized the instant administrative proceeding.

But even if the "knowingly" standard of Section 93 were applicable in the instant case, these Directors are still liable here. "Knowingly" refers to awareness of the facts, not awareness of the law. *Anderson v. Akers*, 9 F.Supp. 151 (W.D. Ky. 1934), supp. op. 11 F.Supp. 9 (W.D. Ky, 1935), modified *Atherton v. Anderson*, 86 F.2d 518 (6th Cir. 1936), rev'd on other grounds 302 U.S. 643 (1937); *U.S. v. International Minerals & Chemical Corp.*, 402 U.S. 558 (1971); *U.S. v. Corbin Farm Service*, 444 F.Supp. 510 (E.D. Calif. 1978).

There was but one important factual issue with respect to liability which was not resolved by the pleadings. That issue was whether or not the proceeds of the third credit extension, made to Mr. Ware on June 11, 1979, were used for the benefit of the Fame corporation. See 12 C.F.R. § 7.1310(c)(3); *First National Bank of Lincolnwood v. Keller*, 318 F.Supp. 339 (N.D. Ill., 1970).[2] (The Directors admitted in their Answer that they knew the proceeds of this loan *were to be reloaned* to Fame by Ware.)

Evidence on this issue was received at the evidentiary hearing. The testimony there established that the proceeds of this loan were deposited directly into Fame's checking account at the Bank.

There is no direct evidence in the record as to what precise purposes these loan proceeds were ultimately used for. But the fact of their deposit in Fame's account certainly justifies the inference that they were, in fact, used for the benefit of Fame. And the administrative law judge so finds.

Accordingly, the administrative law judge finds and concludes that both the credit extension to Fame itself on May 9, 1979 in the amount of $225,000 and the loan to Mr.

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[2]The Directors admitted such use of the Lewis loan proceeds in their Answer to the Amended Notice.

Ware on June 11, 1979 in the amount of $125,000 were made in violation of 12 U.S.C. § 84, and that the Directors can be held liable with respect thereto pursuant to the provisions of 12 U.S.C. § 1818(b). A cease and desist order may lawfully be issued and served on the Directors, as well as on the Bank, and it may require the Directors to take affirmative action to correct the conditions resulting from the credit extensions of May 9, 1979 and June 11, 1979.

The Directors assert that certain requirements set out in § 1818(c) have not been shown to exist, *i.e.*, insolvency or substantial dissipation of assets or seriously weakened condition of the Bank, resulting from their actions. This argument is totally irrelevant. Section 1818(c) has to do with a *temporary* order to cease and desist, effective immediately upon its being served. Such an order is in effect pending completion of the plenary administrative proceeding. An order of this nature was, indeed, served in this case. Relief from it was obtainable from a United States District Court. The administrative law judge is not concerned with either that order or Section 1818(c).

III

Extent of Directors' Potential Liability

Section 1818(b) provides that the OCC may require the Directors "to take affirmative action to correct the conditions resulting from" their violations of Section 84.

Do any such "conditions" exist which call for correction? (Both sides appear to consider these conditions to be synonymous with the term "damages" as used in 12 U.S.C. § 93.)

The proposed findings of fact submitted by the parties are meagre with respect to the precise present status and balances of the two unlawful credit extensions. Based on

the submissions, and the supporting citations,[3] the administrative law judge finds that the Ware loan was paid off in full by resort to the bonds posted as security of it, but the that there is an outstanding balance on the Fame loan in the amount of $41,000.

The full amount of the first, lawful loan to Mr. Lewis also remains unpaid and the OCC maintains that the Directors can be required to repay this amount to the Bank. The OCC's argument seems to be, in essence, that had it not been for the two unlawful credit extensions for Fame's benefit, the full amount of the first, lawful loan could, and would, have been repaid or recovered in full. This argument is purely speculative. There is no solid evidence to support it.

Nor is there support for the theory of it in the decided cases. None of the cases cited by the parties here has held directors liable for the outstanding balance of a single loan or credit extension which initially and entirely was within lawful lending limits. In *Corsicana National Bank v. Johnson* (1919) 251 U.S. 68, it is true, the directors were held responsible for the entire amount of the loan, not just the excess portion of it which exceeded the lawful lending limit. But there was only one loan in that case. The entire amount of the loan was held to have been unlawfully made because the total amount of it was excessive. Accordingly the directors there were liable to make the bank whole for the entire amount of it, not merely the portion of it which was excessive.

In our case, there have been three separate loans. The second and third were unlawfully in excess of permitted limits. But the first one, though made for the benefit of

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[3]At the close of the hearing counsel were directed to provide specific citations to the record for each proposed finding submitted. Tr. 328.

Fame, was not made in violation of law. Section 1818(b) simply does not authorize the OCC to require these Directors to make this Bank whole with respect to the outstanding balance on such a lawful loan.

The OCC argues that, regardless of the propriety of that original loan, the Directors can be compelled to reimburse the Bank to the extent of the unpaid balance of it because they failed to take effective steps to eliminate that balance from certain available resources before those resources were used to reduce the unlawful Fame and Ware loans.

It is conceivable that justification might be found for requiring the application of credits or securities to eliminate balances of earlier, lawful loans before subsequent unlawful ones, where the credits and securities may properly be applied against both categories of loans. By permitting directors in such a sitution first to reduce the unlawful loans, the bank is left with the earlier, lawful loans unpaid and without recourse to the wrongdoing directors. No convincing authorities are presented by the OCC in support of such an argument, however.

But in any event, that is not this case. When the bonds securing the Ware loan were sold the amount realized was apparently just enough to reduce that loan balance to zero.[4] The OCC cites no authority that would permit a bank to apply collateral specifically pledged as security for a particular loan to A in order to reduce the balance outstanding on a different loan to B.

The balance of the Fame loan apparently was reduced to zero initially by offset against the balance in a checking account belonging to Fame. As the result of certain bankruptcy proceedings some of those offset funds were returned

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[4]Here, again, the proposed findings of fact submitted with supporting citations are meagre.

to Fame and the unpaid balance on the Fame loan now apparently stands at $41,000. The OCC cites no authorities that would have justified offsetting any additional balance in that checking account against the Bank's original loan, to Rehbock Lewis. The OCC regulation and the cited case law may permit aggregation of loans to separate entities for Section 84 purposes, but they do not purport to alter the legal principles governing the right to offset.

The OCC did not submit proposed findings, with supporting citations, that would show a course of fraudulent conduct on the part of the Directors, or deceptive practice, although such an intentional course of wrongful conduct might permit fastening liability on the Directors for the lawful loan.

Thus, the only specific dollar amount of "conditions resulting", or damages, identified in the post hearing submissions, which the Directors can properly be required to repay, is the $41,000 outstanding balance on the unlawful Fame loan.

The OCC asserts that, in addition, the Directors can be required to indemnify the bank for lost interest on that $41,000 balance of principal, and for all expenses incurred by the Bank in connection with efforts to collect on the two unlawful loans, as well as all attorneys' fees paid for defending the Directors in this administrative proceeding. The language of Section 1818(b) — "the conditions resulting" — is broad enough to include these items, and the administrative law judge so concludes. Again, there are no proposed findings with supporting citations to the record sufficient to permit findings here as to the specific amounts involved. If the parties are unable to stipulate and agree as to such matters, this record can be reopened for further evidence as to the same.

IV

The Comptroller's Discretion

As demonstrated above, it would be lawful for the Comptroller to provide, in a "cease and desist" order, that these Directors must take affirmative action to correct the conditions resulting from their violations of law. *Should* he do so, in the exercise of his discretion?

One of the oldest and most basic principles of our law is that, when one of two innocent parties must bear a loss, he who caused the loss should be the one to bear it. *Henry v. Auchincloss*, 305 F.2d 753 (D.C. Cir., 1962).

From the record here it appears that these Directors are "innocent" in the sense that they did nothing maliciously or with evil intent. Nonetheless, had they obeyed the law, and not exceeded the lawful lending limits, certain losses would not have been sustained. It is only fair and appropriate then that, as between the Bank and the Directors, the Directors who caused those losses should bear them.

The administrative law judge has carefully considered all of the arguments made by the Directors in defense. Their argument of ignorance warrants specific comment. Very simply, when they undertook to serve as directors of a bank, they knew or should have known that they were assuming responsibility for other peoples' money. Therefore they should have realized that their conduct would be subject to regulation by law and government authorities. Reasonable and prudent persons in such a situation would make it a point to inform themselves as to what the law and the government authorities required of them. These Directors failed to do so. The Bank, its depositors and shareholders, should not have to bear the resulting losses. The Directors should bear them.

Belatedly, at the hearing, the Directors seemed to be attempting to make the point that theirs is a "minority bank", allegedly organized to help a "minority" group, that the Directors thus were engaging in an altruistic enterprise, and as a consequence some lesser degree of responsibility should be expected of them than of the directors of an ordinary bank.[5] After the hearing the administrative law judge permitted counsel for the Directors to make a proffer with respect to the status and responsibilities of a "minority bank" and its directors. After considering the proffer made the administrative law judge concluded that any issue with respect to the Bank's being a "minority bank" should have been raised before the hearing and that any evidence in that connection should have been proffered at the hearing. (Memorandum To Counsel dated December 19, 1980).

After consideration of all of the arguments of the Directors, the administrative law judge concludes that the Comptroller should enter a "cease and desist" order in this matter and include a provision requiring the Directors who participated in the unlawful loans to correct the conditions resulting therefrom.

V

Directors Identified

The proposed findings submitted do not identify which Directors are liable. However, Exhibit OCC-X-003, page 4, identifies the following as the Directors who approved the May 9, 1979 loan to Fame Furniture: Tirso del Junco, Antonio E. Valle, Walter L. Rasic, Andres Alonzo, Jr.,

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[5]It should be noted that at the hearing Donald Jewett, sometime assistant vice-president, loan officer, discount committee member, vice-president, manager and senior loan officer at the main office of the Bank testified that the term "minority bank" meant nothing to him with respect to the Bank. (Tr. 157-159)

Gilbert R. Vasquez, C. V. Holder, Martin Castillo and Grace C. Quinn; and the administrative law judge so finds. They should be required to take affirmative action to correct the condition resulting therefrom, viz., indemnify the bank to the extent of the outstanding balance plus interest due on the Fame loan.

All of those named above, plus Hal W. Brown, Jr., who approved the June 11, 1979 loan to Ralph Ware, according to the same source, should be required to take affirmative action to correct the conditions resulting from the two unlawful loans, viz., idemnify the bank to the extent of all expenses incurred by the Bank in connection with efforts to collect on the two loans, as well as for attorneys' fees paid for defending the Directors in this administrative proceeding.[6]

CONCLUSIONS OF LAW

Based upon the foregoing discussion and the findings of fact included therein, and after careful consideration of all of the arguments of counsel, the administrative law judge makes the following conclusions of law:

1. The Bank and certain Directors violated 12 U.S.C. § 84 by making and approving the loans to Fame Furniture Co., Inc. and to Ralph Ware.

2. As a consequence of those violations, it is lawful for the Comptroller to issue a "cease and desist" order to the Bank and those Directors pursuant to 12 U.S.C. § 1818(b).

3. It is lawful for such a "cease and desist" order to include mandatory provisions requiring those Directors to

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[6]The OCC did not request in the post-hearing submissions that these Directors be required to indemnify the Bank for the Bank's attorneys' fees.

take affirmative action to correct the conditions resulting from those illegal loans.

4. The Comptroller, in the exercise of his discretion, should issue such an order as described in 2. and 3., above, in appropriate form.

5. The corrective action required of the Directors should consist of:

a. Indemnifying the Bank to the extent of the balance remaining unpaid on the loan to Fame Furniture Co., Inc., plus interest thereon (The Directors to whom this provision should be directed are Tirso del Junco, Antonio E. Valle, Walter L. Rasic, Andres Alonzo, Jr., Gilbert R. Vasquez, C. V. Holder, Martin Castillo, and Grace C. Quinn.); and

b. To indemnify the Bank for any and all sums paid by the Bank for attorneys' fees for the Directors in connection with this administrative proceeding (The Directors to whom this provision should be directed are all of those named in 5.a., above, plus Hal W. Brown, Jr.).

A proposed order for the signature of the Comptroller, in accordance with the foregoing recommendations, findings and conclusions is attached hereto.

Respectfully submitted,

/s/ Francis L. Young
Francis L. Young
Administrative Law Judge

APPENDIX C.

Decision of the Comptroller of the Currency.

United States of America,
Department of the Treasury,
Office of the Comptroller of the Currency.

In the Matter of Los Angeles National Bank, Los Angeles, California. Docket No. AA-EC-80-9.

The Los Angeles National Bank, Los Angeles, California ("Bank") and the individual members of its Board of Directors ("Directors") having been served with a notice of charges on May 22, 1980, by the Office of the Comptroller of the Currency ("Comptroller"), pursuant to 12 U.S.C. §1818(b), appeared through counsel at a hearing held on November 5 and 6, 1980, before the Honorable Francis L. Young, Administrative Law Judge ("ALJ"). Following receipt by the Comptroller of the entire record of the proceedings, including the ALJ's recommended decision and exceptions to said decision filed by counsel for the Comptroller[1], the parties were notified on March 30, 1981, that the case had been submitted to the Comptroller for final decision. Now follows the Comptroller's final decision and accompanying order to cease and desist.

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[1]Counsel for the Directors did not file exceptions to the ALJ's recommended decision, but did file a reply to the exceptions submitted by counsel to the Comptroller. The Directors' reply was received April 3, 1981. The Comptroller's Rules of Practice and Procedure, 12 C.F.R. Part 19, pursuant to which this administrative proceeding has been conducted, provide for the filing of exceptions by the parties (see 12 C.F.R. §19.12) but do not authorize the filing of a reply to a party's exceptions. However, the Directors' reply received April 3 has been accepted into the record and considered in this decision.

I. VIOLATIONS BY THE BANK.

As finally amended, the Comptroller's notice of charges alleged violation by the Bank and the Directors of 12 U.S.C. §84.[2] Section 84 provides in pertinent part:

> The total obligations to any national banking association of any person, co-partnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. . . .

The notice of charges, by incorporating a portion of a report of examination, detailed the alleged violations of the law as follows:

> The following loans are combinable and subject to the limits of 12 U.S.C. 84, as all funds were used by Fame Furniture Co., Inc. for business purposes, and the source of repayment is business income of Fame Furniture Co., Inc.

Date Granted	Borrower	Amount	Lending Limit	Excess Amount
1-19-79	Rehbock Lewis	225,000		
5-9-79	Fame Furniture Co., Inc.	225,000		
	Subtotal	450,000	272,866	177,134
6-11-79	Ralph Ware	125,000		
	Present Balance	575,000	277,108	297,892

Captioned "Cease-and-desist proceedings," 12 U.S.C. §1818(b) provides in pertinent part:

> (b)(1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any director, . . . or other person

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[2]The discussion in sections I and II of this decision, relating to the Bank's and the Directors' violation of 12 U.S.C. §84, is in essential conformity with the discussion and findings of the ALJ. See ALJ Recommended Decision 6-12.

> participating in the conduct of the affairs of such a bank is engaging or has engaged, . . . in an unsafe or unsound practice in conducting the business of such bank or is violating or has violated, . . . a law, rule, or regulation, . . . the agency may issue and serve upon the bank or such director, . . . a notice of charges . . . . The notice shall contain a statement of the facts . . . and shall fix a time and place at which a hearing will be held. . . . [I]f upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director, . . . and order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory . . ., require the bank or its directors, . . . to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

In its answer, the Bank admitted that it is subject to these statutory provisions, and that it had extended credit for the benefit of Fame Furniture Company, Inc. ("Fame"), in an amount exceeding its legal lending limit established by the provisions of 12 U.S.C. §84. The record clearly establishes the loans or credit extensions, and legal lending limits, as specified above. The Comptroller hereby finds, as did the ALJ, that the Bank has violated 12 U.S.C. §84 and that a cease-and-desist order may be issued and served on the Bank to correct such violation.

II. VIOLATIONS BY THE DIRECTORS.

With respect to the Directors, the amended notice of charges alleged:

> 5(a) On January 19, 1979, the BANK made a $225,000 credit extension in the name of Rehbock Lewis, President of the Fame Furniture Company, Inc.

(FAME), the proceeds of which were used for the benefit of FAME. The Board of Directors approved of and permitted this credit extension with knowledge of its purpose and amount.

(b) On May 9, 1979, the BANK extended credit to FAME in the amount of $225,000. The Board of Directors approved of and permitted this credit extension with knowledge of its purpose and amount.

(c) On June 11, 1979, the BANK made a $125,000 credit extension in the name of Ralph Ware, Treasurer and Assistant Secretary of FAME, the proceeds of which were used for the benefit of FAME. The Board of Directors approved and permitted this credit extension with knowledge of its purpose and amount.

(d) The BANK's legal lending limit as established by 12 U.S.C. §84 was $272, 866 on May 9, 1979 and $277,108 on June 11, 1979.

(e) As of May 9, 1979, no reductions in principal had been made on the credit extension alleged in paragraph (5)(a) above.

(f) As of June 11, 1979, no reductions in principal had been made on the credit extension alleged in paragraph 5(a) above.

(g) The Board approved the credit extensions alleged in paragraphs (5)(b) and 5(c) in violation of 12 U.S.C. §84.

In their answer filed with the ALJ on July 21, 1980, the Directors "separating themselves from each other, individually answer[ed]" as follows:

5(a) Admits that on or about January 19, 1979, the BANK made a $225,000 credit extension in the name of Rehbock Lewis, President of the Fame Furniture Company, Inc. (FAME), the proceeds of which were used for the benefit of FAME; and the Board of Directors approved this credit extension with knowledge

that the principal amount would be reloaned to FAME by Mr. Lewis. Except as expressly admitted, each of the Directors denies the allegations of Paragraph (5)(a).

(b) Admits that on May 9, 1979, the BANK extended credit to FAME in the amount of $225,000; and the Board of Directors approved this credit extension with knowledge that the principal amount of the credit extension was $225,000 and that the proceeds were used for the benefit of FAME. Except as expressly admitted, each of the Directors denies the allegations of Paragraph (5)(b) and specifically denies that the credit extension was made with the knowledge that it violated the BANK's legal lending limit or 12 U.S.C. §84 or that any such information or knowledge was brought to the attention of the Directors or any of them.

(c) Admits that on June 11, 1979 the BANK made a $125,000 credit extension to Ralph Ware, the proceeds of which would be reloaned to FAME by Mr. Ware and that the Board of Directors approved this credit extension with knowledge that the principal amount of the credit extension was $125,000 and that the proceeds were to be reloaned to FAME by Mr. Ware. Except as expressly admitted, each of the Directors denies the allegations of Paragraph (5)(c) and specifically denies that the credit extension was made with the knowledge that it violated the BANK's legal lending limit or 12 U.S.C. §84 or that any such information or knowledge was brought to the attention of th Directors or any of them.

(d) Admits that the BANK's legal lending limit as established by 12 U.S.C. §84 was $272,866 on May 9, 1979 and $277,108 on June 11, 1979.

(e) As of May 9, 1979, no reductions in principal had been made on the credit extension alleged in paragraph (5)(a) above.

(f) As of June 11, 1979, no reductions in principal had been made on the credit extensions alleged in paragraphs (5)(a) and (5)(b) above.

(g) Admits that the credit extensions alleged in paragraphs (5)(b) and (5)(c) would violate 12 U.S.C. §84 if they were aggregated as a legal matter as alleged by the Comptroller. Except as expressly admitted, each of the Directors denies the allegations contained in (5)(g) and specifically denies that said credit extensions were made with the knowledge that either one or both violated the BANK's legal lending limits or 12 U.S.C. §84.

Thus the record clearly establishes that the Directors approved each of the three subject credit extensions with knowledge that the proceeds were intended to be used for the benefit of Fame. The record clearly establishes also that the three credit extensions were made by the Bank. The principal controversy in the case has revolved around whether or not on these facts the Directors can be found to have violated 12 U.S.C. §84.

The Comptroller's Interpretive Ruling 7.1310(c)(3), 12 C.F.R. §7.1310(c)(3), implementing the lending limit statute, provides:

> Obligations of a corporation must be combined with any other extension of credit the proceeds of which are used for the benefit of the corporation.

This ruling is based on long-standing case law under 12 U.S.C. §84, has been published in its current form since 1973, and is contained in the Comptroller's Manual for National Banks which is provided to every national bank.[3]

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[3]On aggregation, see, e.g., *Corsicana National Bank v. Johnson*, 251 U.S. 68, 81 (1919); *Hughes v. Reed*, 46 F.2d 435, 442 (10th Cir. 1931); *Atherton v. Anderson*, 86 F.2d 518, 529 (6th Cir. 1936), *rev'd. on other grounds* 302 U.S. 643 (1937).

The Directors admit that they knew the amounts of the three subject credit extensions which they approved, to Mr. Rehbock Lewis (president and 70 percent owner of Fame), Fame itself, and Mr. Ralph Ware (treasurer and assistant secretary of Fame), and that the proceeds were intended for the benefit of Fame (in the case of the Lewis and Ware loans, "the proceeds were to be reloaned to Fame", *supra* Directors' admissions (5)(a) and (c)). Furthermore, the Directors admit that the extensions of credit would violate 12 U.S.C. §84 if they were aggregated as a legal matter.

On the matter of aggregation and consequent Directors' liability, the Directors have made two arguments. First, they have contended that although they knew the Ware loan proceeds were to be reloaned to Fame, the evidence does not show that the proceeds were in fact used for the benefit of Fame. The Directors' reply brief dated February 6, 1981, at 10 notes:

> The evidence merely establishes that the proceeds [of the Ware loan] were deposited to Fame's checking account. There is absolutely no evidence which establishes what the funds were then in fact used for, whether corporate or personal.

The hearing record clearly discloses the purpose and use of proceeds of the Ware loan. Mr. Ware, Fame's treasurer, testified that Fame's checking account at another bank was overdrawn. Accordingly, he and Mr. Lewis, Fame's president, went to the Bank to procure another loan. The Bank's vice president and senior lending officer, Mr. Jewett, informed Lewis and Ware that the Bank could not make an additional loan to Fame or to Mr. Lewis without violating the Bank's legal lending limit. Therefore, Mr. Ware's "name was used for the loan papers to borrow the money." Hearing Transcript 50-51. As agreed, the Bank put the Ware loan proceeds directly into Fame's corporate checking ac-

count. Hearing Transcript 51-52. See also Hearing Transcript 179-80, wherein Mr. Jewett testified that he knew the proceeds were "going to go through Mr. Ware to Fame." On these facts, the Comptroller agrees with the ALJ's finding and conclusion that the deposit of the Ware loan proceeds directly into Fame's corporate checking account shows that the proceeds were used for the benefit of Fame.

Second, and more generally, the Directors have contended that none of the three loans, viewed separately, exceeded the Bank's lending limit, that the Directors did not know the Comptroller would aggregate the three transactions, and that therefore they are not liable under 12 U.S.C. §1818(b) for a knowing violation of 12 U.S.C. §84. The Directors, having admitted knowledge of the facts constituting the lending limit violation, cannot successfully plead ignorance of the law as a defense. They knew, or should have known, that the three Fame-related credits would be aggregated and thereby exceed the Bank's legal lending limit.

The Directors cite 12 U.S.C. §93, which fastens liability on bank directors who "shall knowingly violate" certain provisions of law, including 12 U.S.C. §84. The present proceeding, however, has not been brought pursuant to 12 U.S.C. §93. Section 93 provides for the bringing of an action against directors in a United States district court. It was enacted long before 12 U.S.C. §1818(b), which authorizes the instant administrative proceeding.

Even if the "knowingly" standard of 12 U.S.C. §93 were applicable, the Comptroller agrees with the ALJ's finding that the Directors are still liable here. "Knowingly" refers to awareness of the facts, not awareness of the law. *Cockrill v. Cooper*, 86 F. 7, 12 (8th Cir. 1898); *Anderson v. Akers*, 7 F. Supp. 924, 946 (W.D. Ky. 1934), supp. op. 11 F. Supp. 9 (W.D. Ky. 1935), *modified sub nom. Atherton*

v. Anderson, 86 F.2d 518 (6th Cir. 1936), *rev'd on other grounds* 302 U.S. 643 (1937); *U.S. v. International Minerals & Chemical Corp.*, 402 U.S. 558 (1971); *U.S. v. Corbin Farm Service*, 444 F. Supp. 510 (E.D. Calif. 1978).

In sum, the Comptroller agrees with the ALJ that the Bank, and those Directors who approved the loans to Fame and Ware, violated 12 U.S.C. §84, and that such Directors must indemnify the Bank pursuant to 12 U.S.C. §1818(b). Now follows a discussion of the amount of the Directors' liability.

III. RECOVERIES SHOULD BE APPLIED FIRST TO THE LAWFUL LEWIS LOAN.

The cease-and-desist proceedings statute, 12 U.S.C. §1818(b), provides that the Comptroller may require national bank directors "to take affirmative action to correct the conditions resulting from" their violations of law, in this case 12 U.S.C. §84. The "conditions" in this instance are the damages suffered by the Bank due to the Directors' violation of the lending limits on the Fame-related credits.

The Rehbock Lewis loan in the amount of $225,000, made for the benefit of Fame, was legal when made because it did not exceed the Bank's lending limit. The Fame loan in the amount of $225,000, and the Ralph Ware loan in the amount of $125,000, intended and used for the benefit of Fame, were each illegal because they exceeded the Bank's lending limit when aggregated with the earlier Rehbock Lewis loan. As explained in *Corsicana National Bank v. Johnson*, 251 U.S. 68 (1919), bank directors are held responsible for the entire amount of an unlawful loan, not just the portion of the loan that exceeds the 12 U.S.C. §84 lending limit. This means that the Directors are potentially

liable for $350,000 in principal amount, the total of the illegal Fame and Ralph Ware loans.[4]

The evidence indicates that the first, lawful loan to Rehbock Lewis stands with a principal amount of $202,798 unpaid. Hearing Transcript 139. The unlawful Fame loan stands at $46,545. This reduction was achieved by offset against the balance in a checking account belonging to Fame. Hearing Transcript 60-61; OCC Exhibit 004, at 8. The bonds pledged by Rehbock Lewis to secure the unlawful Ralph Ware loan were sold, and the amount realized reduced the Ralph Ware loan balance to zero.

The ALJ rejected the contention of counsel for the Comptroller that the collections made by the Bank on the Fame-related loans, i.e., the loans to Lewis, Fame, and Ware, should not reduce the amount of the Directors' liability on the two illegal loans until the first, legal loan has been fully paid. Once the Lewis loan has been paid, said the Comptroller's counsel, then any further collections could go toward reduction of the Directors' liability on the illegal Fame and Ware loans. The ALJ, however, reasoned that the Fame checking account could be used only to reduce the Fame loan, and the Lewis bonds pledged to secure the Ware loan must be used to pay off the Ware loan. He observed that counsel for the Comptroller cited no authority that would permit a bank to apply collateral pledged as security for a particular loan to A in order to reduce the balance on a different loan outstanding to B, or that would authorize the Bank to offset Fame's checking account against the original loan to Lewis. ALJ Recommended Decision 13-15.

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[4]Section IV of this decision discusses the Directors' liability for lost interest on the Fame and Ware loans, for collection expenses incurred by the Bank, and for the Directors' attorney fees paid by the Bank.

The Comptroller disagrees with this line of reasoning by the ALJ and instead finds that the Directors' liability on the Fame and Ware loans should not be reduced by recoveries until the Lewis loan has been fully repaid with interest. This result does not require that the legal principles governing offsets and pledged collateral be altered by 12 U.S.C. §84 or §1818(b), or administrative remedies fashioned pursuant thereto. I assume, *arguendo*, that the Bank could only apply the proceeds of Fame's corporate checking account to pay off or reduce the Fame loan, and had to first apply the proceeds derived from the sale of the Lewis bonds securing the Ware loan to pay off said loan.

Offsets and the sale of collateral to pay off a loan involve the relationship between the Bank and the borrowers, not the relationship between the Bank and its Board of Directors. The latter relationship is the subject of these proceedings. As the ALJ noted, "[b]y permitting directors in such a situation first to reduce the unlawful loans, the bank is left with the earlier, lawful loans unpaid and without recourse to the wrongdoing directors." ALJ Recommended Decision 14. This need not be the case.

In *Corsicana National Bank, supra*, the U.S. Supreme Court stated:

> Assuming the Fleming and Templeton notes were found to represent an excessive loan, knowingly participated in or assented to by defendant as a director of the Bank, in our opinion the cause of action against him accrued on or about June 10, 1907, when the Bank through his act parted with the money loaned, receiving in return only negotiable paper that it could not lawfully accept because the transaction was prohibited by §5200, Rev. Stats. [12 U.S.C. §84]. The damage as well as the injury was complete at that time, and the Bank was not obliged to await the maturity of the notes,

> because immediately it became the duty of the officers or directors who knowingly participated in making the excessive loan to undo the wrong done by taking the notes off the hands of the Bank and restoring to it the money that had been loaned. (251 U.S. 86)

In the instant case, the loan proceeds were disbursed in three separate transactions over time. With respect to the unlawful Fame loan and Ware loan, the damage and injury were complete at the time the loans were made. Subsequent collections should not accrue to the benefit of the Directors until the lawful first loan is paid off.[5]

The Comptroller's remedy of applying recoveries on the Fame-related loans first to the lawful Lewis loan follows the approach taken in *First National Bank of Lincolnwood v. Keller*, 318 F.Supp. 339 (N.D. Ill., E.D. 1970). In this case the defendant, a former bank director, had approved loans to Automatic Accounting Corporation, PMC America, Inc., and Sports Packaging Corporation that, when combined, exceeded the bank's legal lending limit. Substantial recoveries on these lines of credit were made subsequent to the extensions of credit that exceeded the bank's lending limit. At the time of the court's decision, the remaining unpaid loans to these obligors were $21,808.39 (Automatic Accounting), $107,186.92 (PMC), and $77,854.54 (Sports Packaging), for a total of $206,849.85 to all three entities.

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[5]The Directors have cited the *Corsicana National Bank* case for the proposition that recoveries on the illegal loans must be applied to reduce the Directors' liability "on those loans." See Directors' Reply to Comptroller's Counsel Exceptions to ALJ Recommended Decision, at 2; Directors' Reply Brief, at 8. While it is true that the court observed, at 251 U.S. 87, that "whatever of value the Bank recovered from the borrowers on account of the loan would go in diminution of damages . . .," the observation related to a single loan, not to a series of loans with the first credit extension being legal. In other words, this case did not address the question of whether recoveries should be applied to reduce directors' liability on an excessive loan while an earlier, lawful loan to the same borrowers remains unpaid.

318 F.Supp. 342. The court calculated damages on the Automatic Accounting-PMC loans to be the difference between the greatest amount of the combined obligations of the two corporations, $219,733.77—without reducing this amount by subsequent recoveries—and the outstanding balance on loans made prior to the first loan that exceeded the bank's lending limit, $156,578.33, leaving $63,155.44 as the amount of director liability on this series of loans. Sports Packaging's obligations prior to the first excessive loan were $170,171.38, and its largest total of obligations reached $206,807.44—again without reducing the amount of subsequent recoveries. The damages equaled the difference between these two figures, or $36,636.06. 318 F.Supp. 347. In other words, the court looked at the total amount of loans that were illegal and did not reduce the damages by subsequent collections made. The subsequent collections accrued to the benefit of the bank because they were applied to the legal loans.

A different approach had been taken in *Federal Deposit Ins. Corp. v. Mapp's Ex'r*, 37 S.Ed.2d 23 (S. Ct. App. Va. 1946). This earlier, state court decision seems to be distinguishable from *Lincolnwood* on its facts. Thus, in *Mapp's Ex'r*, the bank was owed $9,500 by a realty company and held various liens and assignments as security for the debt. In order to avoid a judgment in bankruptcy against the realty company as a result of action by other creditors, which would have invalidated the liens and assignments held by the bank, the bank extended another $8,450 loan to the company. The second loan exceeded the bank's lending limit and the directors who assented thereto were held liable. The two loans totalled $17,950. The bank and its receiver (the FDIC) collected $11,657.38 from the liquidation of the realty company's assets. The receiver sought the right to apply the collections from the assets of the realty company

on "either or both notes as it saw fit." 37 S.E.2d 27. However, the state court found that if the bank directors had taken no action in the bankruptcy proceedings, *i.e.*, had not extended the $8,450 loan in excess of the bank's lending limit, the realty company would have been adjudged a bankrupt immediately and all creditors would have shared pro rata in the liquidation of its assets. The bank would have received approximately 42 percent of the net proceeds. The court held that this 42 percent, or $4,896.10, should have been credited on the $9,500 indebtedness, and the remaining $6,761.28 collected by the receiver should have been credited on the $8,450 note. The court concluded that the difference, $1,688.72, seemed to be the total loss sustained by the action of the directors in making the excess loan of $8,450 to the realty company. 37 S.E.2d 27-28.

Although the court in *Mapp's Ex'r* did not fully elaborate its rationale, the assessment of damages seems to be based on the facts showing the directors had exercised their business judgment to improve the bank's lien position and avoid an immediate bankruptcy proceeding against the borrower. In these circumstances, it seems entirely appropriate that such facts should be recognized, not to overcome the violation of 12 U.S.C. §84, but to justify mitigation of damages stemming from the violation.

But such mitigating circumstances are not present in these proceedings, whose facts resemble instead the *Lincolnwood* case. As between the Bank and the wrongdoing Directors, the Bank should receive the benefit of collections made, an approach that is also consistent with *Corsicana National Bank, supra*, at 86, which pointed out that the damage and injury stemming from a 12 U.S.C. §84 violation are complete at the time an illegal loan is made.

The facts developed in this administrative proceeding show the appropriateness of making the Bank whole for the

two illegal loans assented to and approved by the Directors. The Lewis loan, admittedly intended for and used for the benefit of Fame, was unsecured.[6] Lewis was president and 70 percent owner of Fame. Far from securing the Bank's position on the Lewis loan, the Directors caused the Bank to make an additional, unsecured loan to Fame. When Fame then needed a third loan to cover an overdrawn account at another bank, the Directors still did not act to secure the Lewis and Fame loans. Instead, they extended a loan to Fame in the name of Ware, see discussion, *supra*, at 7-8. Lewis pledged some of his bonds, with a market value of $126,000 at the time, to secure the Ware loan. OCC Exhibit 010 (Ware loan credit report).

Following an examination of the Bank, the Comptroller's San Francisco regional office informed the Bank of the excessive loans to Fame and Ware and indicated that the Directors were personally liable to restore the funds to the Bank. The Directors resisted such restoration and instead aggressively pursued collections on the two illegal loans. In doing so, they chose not to follow the advice of Mr. Richard Balogh, president of the Bank, who in a special Board of Directors meeting stated that "the first loan to be paid off should be that of Rehbock Lewis and not Fame

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[6]Perhaps as a matter of prudent banking, the loan *should* have been secured. The evidence supports an inference that the Directors were relying on certain securities and bonds owned by Lewis and maintained in a safe deposit box at the Bank as a secondary source of repayment for the loan. The loan credit report on the Lewis loan (OCC Exhibit 005) listed receivables of Fame and/or the sale of certain bonds as the source of payment for the loan. The comments section of the credit report noted that Mr. Lewis' net worth included liquid assets of approximately $400,000 in corporate and municipal bonds of sound quality. The bonds, maintained in a safe deposit box at the Bank, were reviewed by the loan officer who recommended the loan. The discussion of the Lewis bonds in the Bank's safe deposit box was repeated in the Bank's discount committee report of the following day, when the Lewis loan was approved by said committee. OCC Exhibit 006.

Furniture, since the stockholders might claim that this loan was paid to limit the liabilities of the directors." OCC Exhibit 015, at 7 (Minutes of February 21, 1980 Board meeting). A few days following this meeting, the Bank offset Fame's checking account to pay off the Fame loan. This action drove the company into Chapter 11 bankruptcy. Hearing Transcript 60-61. The Bank also obtained a sweeping third party security interest from Lewis covering all Fame-related credits. In June 1980, the Bank sold the Lewis bonds and thereby paid off the Ware loan. The Bank also used the Lewis bonds to reduce the lawful Lewis loan by $22,292, leaving an unpaid principal balance on this loan of $202,708. Hearing Transcript 67, 69, 274; OCC Exhibit 004, at A-10 (report of examination). In September 1980, the Bank settled with Fame, agreeing to return $46,545 to the company, which was now operating in bankruptcy. Hearing Transcript 61-62; OCC Exhibit 004, at 8. As a result, $40,000 principal and $6,545 in interest remained outstanding on the illegal Fame loan, the illegal Ware loan was totally paid off, and the bulk of the legal Lewis loan, $202,708, remained unpaid.

On these facts, it is appropriate that recoveries on the Fame-related credits (the legal Lewis loan and the illegal Fame and Ware loans) should accrue to the benefit of the Bank until such time as the initial Lewis loan is repaid with interest. Additional recoveries can then be applied to reduce the Directors' liability. This approach avoids promoting a conflict between the Directors' fiduciary duty and the best interest of the Bank, since the Board is encouraged to maximize recoveries on an excessive line of credit without regard to whether a particular recovery would be applied to a legal or illegal loan. This approach also avoids rewarding the Directors for their dilatory tactics in refusing to make the Bank whole and is consistent with national bank director

responsibilities generally. See, e.g., *Bowerman v. Hamner*, 250 U.S. 504 (1919); *Hoehn v. Crews*, 144 F.2d 665 (10th Cir. 1944), *cert. den.* 323 U.S. 773.

IV. AMOUNT OF DIRECTORS' LIABILITY.

As noted, the evidence indicates that the Bank collected $22,278 on the Lewis loan, leaving $202,708 in principal amount outstanding; $185,000 on the Fame loan, leaving $40,000 in principal and $6,545 in interest outstanding; and $125,000 on the Ware loan, reducing the balance to zero. Subtracting the $6,545 in interest outstanding on the Fame loan, this means that the Bank is still owed $242,708 in principal amount on the Fame-related credits (i.e., $202,708 on the Lewis loan and $40,000 on the Fame loan). For this principal amount of $242,708, the Directors should indemnify the Bank.

In addition, the Directors should also make the Bank whole for lost interest on the two illegal loans, for all expenses incurred by the Bank in connection with efforts to collect on the two loans, and for all attorney fees paid by the Bank for defending the Directors in this administrative proceeding. These damages or expenses are all "conditions resulting" from the violation of 12 U.S.C. §84 and within the scope of 12 U.S.C. §1818(b), which authorizes the Comptroller to require bank directors to "take affirmative action to correct the conditions resulting" from a violation of law.[7]

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[7]The ALJ similarly believed that lost interest, collection expenses, and attorney fees were reimbursable items within the scope of the 12 U.S.C. §1818(b) affirmative remedies. ALJ Recommended Decision 16, 19. However, the proposed order to cease and desist that accompanied the ALJ's recommended decision included provisions relating only to lost interest and attorney fees; it did not cover collection expenses. See Article I(3) and (4) of the proposed order. Apparently, the discrepancy between the recommended decision and proposed order resulted from the ALJ's belief that the parties' proposed findings and supporting citations to the record were not sufficiently clear to indicate exactly what amount the Directors should repay the Bank on collection expenses. See ALJ Memorandum and Order dated March 10, 1981, denying counsel for the Comptroller's motion for a clarification of the

(footnote continued on following page)

With respect to damages in addition to the unpaid principal balance on the Fame-related credits, the record is clear on some points. On others, the information is contained in Bank records and is easily accessible to the Directors. It has often been stated that damages may be imposed against a wrongdoer even though the amount of loss or injury cannot be determined with certainty or exactitude. See, e.g., 22 Am Jur 2d, Damages §25 (and citations therein).

The Fame loan and the Ware loan each carried an interest rate of 14¾ percent per annum. Directors' Exhibit B. The Fame loan was granted May 9, 1979, and the Ware loan was granted June 11, 1979. Calculating interest at 14¾ percent per annum from June 1, 1979 to June 1, 1981 (24 months), approximately the date of the attached order, the amount of interest lost by the Bank on these two illegal loans equals $71598.86. This figure is derived by multiplying 14.75 (interest rate) × $242,708 (unpaid principal) × 2 (years outstanding).[8]

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proposed order. Of course, the record also does not disclose exactly what amount has been expended by the Bank on the Directors' attorney fees. However, as the discussion in the text, *infra* at 19-20, indicates, the Comptroller believes that the Directors' liability on all three items — interest on the Fame-related credits, collection expenses, and attorney fees — can be determined with sufficient certitude to justify ordering restitution.

[8]The result is an approximation. The interest calculation cannot be exact for two reasons. First, the interest rate on the illegal Fame and Ware loans is being applied against a principal that derives largely from the Lewis loan. Second, the unpaid principal on the Fame-related credits, $242,708, is substantially less than the original total of $350,000 on the Fame and Ware loans. The interest calculation being used assumes that the reduction of $107,292, the difference between the Fame and Ware loans when made and the current outstanding balance on the Fame-related loans, was achieved as of June 1, 1979. This formulation obviously works in favor of the Directors because in fact no recoveries or collections were made until 1980. See text discussion, *supra*, at 16. However, the Comptroller believes that since an exact figure on lost interest cannot be achieved, the Directors should receive the benefit of any "rounding off" that is done.

The record does not show the amount expended by the Bank in its collection efforts on the Fame and Ware loans or payment of the Directors' attorney fees in this administrative proceeding. However, the amount can be easily determined from Bank records. Accordingly, the attached order contains a provision requiring the Directors, within 30 days of the effective date of the order, to reimburse the Bank for the amount expended by the Bank on these two items.

In sum, the Directors must reimburse the Bank in the amount of $314,306.86 (representing $242,708 in principal plus $71,598.86 interest on the Fame-related credits, said interest being calculated at 14¼ percent per annum for two years). The order provides that once the Directors have paid this amount, the Bank shall transfer to them any remaining interest or rights it may have in the Fame-related credits. In addition, the Directors must reimburse the Bank for collection expenses and attorney fees.

V. DIRECTORS IDENTIFIED.

The record shows that the following Directors approved both the May 9, 1979 loan to Fame and the June 11, 1979 loan to Ware: Tirso del Junco, Walter L. Rasic, Andres Alonzo, Jr., C. V. Holder, Martin G. Castillo, and Grace C. Quinn. In addition, Antonio E. Valle and Gilbert Vasquez approved the Fame loan and Hal W. Brown, Jr. approved the Ware loan. OCC Exhibit 003, at 4 (report of examination).

Accordingly, the first six named Directors are liable for the unpaid principal balance on the Fame-related credits, $242,708, plus interest thereon ($71,598.86 as of June 1, 1981), and expenses incurred by the Bank in its collection efforts and in paying the Directors' attorney fees. The liability of Antonio E. Valle and Gilbert Vasquez is limited

to $225,000 (the original amount of the Fame loan which they approved) plus interest thereon, and the liability of Hal W. Brown, Jr. is limited to $125,000 (the original amount of the Ware loan which he approved) plus interest thereon. Messrs. Valle, Vasquez and Brown, Jr., are also responsible for the Directors' attorney fees paid by the Bank.

Theoretically, the order could also require Messrs. Valle, Vasquez and Brown, Jr., to reimburse the Bank for collection expenses in connection with the loans which they approved. However, as a practical matter, it may be difficult to allocate such expenses to the Fame loan or the Ware loan as separate items. Thus, the attached order does not impose liability for collection expenses on these three individuals.

VI. CONCLUSION.

The attached final order reflects the findings discussed in this decision and is part of the decision. The Directors are ordered to indemnify the Bank for losses suffered as a result of the violation of 12 U.S.C. §84 in the Fame-related credits assented to and approved by the Directors. The loss consists primarily of the principal and interest on the Fame-related credits that remain unpaid. In addition, the Bank and the Directors can easily determine the Bank's collection expenses in connection with the Fame and Ware loans and the Directors' attorney fees paid by the Bank in this proceeding.

/s/ Charles E. Lord
Charles E. Lord
Acting Comptroller of the Currency

Date: June 25, 1981.

APPENDIX D.

Order to Cease and Desist.

United States of America,
Department of the Treasury,
Office of the Comptroller of the Currency.

In the Matter of the Los Angeles National Bank, Los Angeles, California. Docket No. AA-EC-80-9.

A Cease and Desist Order against the Los Angeles National Bank, Los Angeles, California, and certain members of its Board of Directors.

WHEREAS, the Los Angeles National Bank, Los Angeles, California ("Bank"), and certain members of its Board of Directors named below ("Directors"), having appeared through counsel at an administrative hearing held before the Honorable Francis L. Young, Administrative Law Judge, on a notice of charges issued and served upon the Bank and the Directors pursuant to 12 U.S.C. §1818(b) by the Comptroller of the Currency of the United States of America ("Comptroller"); and

WHEREAS, the Comptroller, based on the record of the proceedings and the recommended decision, findings of fact and conclusions of law of the Administrative Law Judge, finds that the Bank and the Directors violated 12 U.S.C. §84 as cited in the notice of charges, and that said violations warrant the issuance of this order to cease and desist ("order");

NOW, THEREFORE, the Comptroller, acting by virtue of the authority conferred on him by 12 U.S.C. §1818(b), hereby orders that:

ARTICLE I

(1) The Bank shall not lend money or otherwise extend credit to any borrower in an amount which exceeds the lending limitations provided in 12 U.S.C. §84.

(2) The Board of Directors shall cause all loans or other extensions of credit which become in the future, for any reason whatsoever, excessive of the lending limitations provided in 12 U.S.C. §84, to be reduced to conforming amounts without loss to the Bank. The Board of Directors shall adopt policies and procedures to prevent recurrence of similar violations.

ARTICLE II

(3) Within thirty (30) days of the effective date of this order, the following named members of the Board of Directors shall indemnify the Bank in the amount of $314,306.86, which amount represents the remaining balance and lost interest on the Fame-related loans, i.e., the January 19, 1979 loan to Rehbock Lewis, the May 9, 1979 loan to Fame Furniture Company, Inc., and the June 11, 1979 loan to Ralph Ware: Tirso del Junco, Walter L. Rasic, Andres Alonzo, Jr., C. V. Holder, Martin Castillo, Grace C. Quinn, Antonio E. Valle, Gilbert R. Vasquez, and Hal W. Brown, Jr., *provided, however*, that the liability of Hal W. Brown, Jr. is limited to $125,000 plus interest thereon at 14¾ percent per annum from June 11, 1979 to the date of payment, *and provided further*, that the liability of Antonio E. Valle and Gibert R. Vasquez is limited to $225,000 plus interest thereon at 14¾ percent per annum from May 9, 1979 to the date of their payment.

(4) Within thirty (30) days of the effective date of this order, all those Directors named in paragraph (3) above shall indemnify the Bank to the extent of all sums paid by the Bank for Directors' attorney fees in connection with the administrative proceeding which has culminated in this order.

(5) Within thirty (30) days of the effective date of this order, all those Directors named in paragraph (3) above,

except for Antonio E. Valle, Gilbert R. Vasquez, and Hal W. Brown, Jr., shall indemnify the Bank to the extent of all sums paid by the Bank in efforts to collect on the May 9, 1979 loan to Fame Furniture Company, Inc. and on the June 11, 1979 loan to Ralph Ware.

ARTICLE III

(6) After the Directors named in paragraph (3) above have indemnified the Bank as directed in paragraph (3), the Bank shall transfer any remaining interest or rights that it may have in the Fame-related loans to those Directors.

ARTICLE IV

(7) The provisions of this order shall become effective thirty (30) days after its service and shall remain effective and enforceable, except to the extent that, and until such time as, any provisions of the order shall have been amended, suspended, waived, or terminated by the Comptroller or by a reviewing court.

It is so ordered this 25th day of June, 1981.

/s/ Charles E. Lord
Charles E. Lord
Acting Comptroller of the Currency

APPENDIX E.

Petition for Review.

United States Court of Appeals for the Ninth Circuit.

Tirso del Junco, Walter L. Rasic, Andres Alonzo, Jr. C.V Holder, Martin Castillo, Grace C. Quinn, Antonio E. Valle, Gilbert R. Vasques, Hal W. Brown, Jr., Petitioners, v. Charles E. Lord, Acting Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury, Respondents.

Filed: July 14, 1981.

Tirso del Junco, Walter L. Rasic, Andres Alonzo, Jr., C.V. Holder, Martin Castillo, Grace C. Quinn, Antonio E. Valle, Gilbert R. Vasquez, Hal W. Brown, Jr. hereby petition the court for review of the Office of the Comptroller of the Currency's order to cease and desist entered on June 25, 1981 in the case entitled:

In The Matter of the Los Angeles National Bank, Los Angeles, California, Docket No. AA-EC-80-9.

DATED: July 14, 1981

IVERSON, YOAKUM, PAPIANO & HATCH
by Patrick McAdam
Patrick McAdam
Attorneys for Petitioners

APPENDIX F.

Pertinent Statutes.

§ *84. Limit of liability of any person to bank*

The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. The term "obligations" shall mean the direct liability of the maker or acceptor of paper discounted with or sold to such association and the liability of the indorser, drawer, or guarantor who obtains a loan from or discounts paper with or sells paper under his guaranty to such association and shall include in the case of obligations of a copartnership or association the obligations of the several members thereof and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest. Such limitation of 10 per centum shall be subject to the following exceptions:

(1) Obligations in the form of drafts or bills of exchange drawn in good faith against actually existing values shall not be subject under this section to any limitation based upon such capital and surplus.

(2) Obligations arising out of the discount of commercial or business paper actually owned by the person, copartnership, association, or corporation negotiating the same shall not be subject under this section to any limitation based upon such capital and surplus.

(3) Obligations drawn in good faith against actually existing values and secured by goods or commodities in process of shipment shall not be subject under this section to any limitation based upon such capital and surplus.

(4) Obligations as indorser or guarantor of notes, other than commercial or business paper excepted under (2) hereof having a maturity of not more than six months, and owned by the person, corporation, association, or copartnership indorsing and negotiating the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(5) Obligations in the form of banker's acceptances of other banks of the kind described in sections 372 and 373 of this title shall not be subject under this section to any limitation based upon such capital and surplus.

(6) Obligations of any person, copartnership, association, or corporation, in the form of notes or drafts secured by shipping documents, warehouse receipts, or other such documents transferring or securing title covering readily marketable nonperishable staples when such property is fully covered by insurance, if it is customary to insure such staples, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such obligation, and to an additional increase of limitation of 5 per centum of such capital and surplus in addition to such 25 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 120 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 30 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 125 per centum of the face amount of such ad-

ditional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 35 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 130 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 40 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 135 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 45 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 140 per centum of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, copartnership, association, or corporation arising from the same transactions and/or secured by the identical staples for more than ten months. Obligations of any person, copartnership, association, or corporation in the form of notes or crafts secured by shipping documents, warehouse receipts, or other such documents transferring or securing title covering refrigerated or frozen readily marketable staples when such property is fully covered by insurance, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition of such 10 per centum of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, copartnership, association, or corporation

arising from the same transactions and/or secured by the identical staples for more than six months.

(7) Obligations of any person, copartnership, association, or corporation in the form of notes or drafts secured by shipping documents or instruments transferring or securing title covering livestock or giving a lien on livestock when the market value of the livestock securing the obligation is not at any time less than 115 per centum of the face amount of the notes covered by such documents shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus. Obligations arising out of the discount by dealers in dairy cattle of paper given in payment for dairy cattle, which bear a full recourse endorsement or unconditional guarantee of the seller and are secured by the cattle being sold, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(8) Obligations of any person, copartnership, association, or corporation secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, treasury bills of the United States or obligations fully guaranteed both as to principal and interest by the United States, shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limiation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(9) Obligations representing loans to any national banking association or to any banking institution organized under the laws of any State, or to any receiver, conservator, or superintendent of banks, or to any other agent, in charge

of the business and property of any such association or banking institution, when such loans are approved by the Comptroller of the Currency, shall not be subject under this section to any limitation based upon such capital and surplus.

(10) Obligations shall not be subject under this section to any limitation based upon such capital and surplus to the extent that such obligations are secured or covered by guaranties, or by commitments or agreements to take over or to purchase, made by any Federal Reserve bank or by the United States or any department, bureau, board, commission, or establishment of the United States, including any corporation wholly owned directly or indirectly by the United States: *Provided*, That such guaranties, agreements, or commitments are unconditional and must be performed by payment of cash or its equivalent within sixty days after demand. The Comptroller of the Currency is hereby authorized to define the . . .

(11) Obligations of a local public agency (as defined in section 1460(h) of Title 42) or of a public housing agency (as defined in the United States Housing Act of 1937, as amended) which have a maturity of not more than eighteen months shall not be subject under this section to any limitation, if such obligations are secured by an agreement between the obligor agency and the Secretary of Housing and Urban Development in which the agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the agency, prior to the maturity of such obligations, monies in an amount which (together with any other monies irrevocably committed to the payment of interest on such obligations) will suffice to pay the principal of such obligations with interest to maturity, which monies under the terms of said agreement are required to be used for that purpose.

(12) Obligations insured by the Secretary of Agriculture pursuant to the Bankhead-Jones Farm Tenant Act, as amended, or the Act of August 28, 1937, as amended (relating to the conservation of water resources), or sections 1471-1485 of Title 42, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

(13) Obligations as endorser or guarantor of negotiable or non-negotiable installment consumer paper which carries a full recourse endorsement or unconditional guarantee by the person, copartnership, association, or corporation transferring the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus: *Provided, however*, That if the bank's files or the knowledge of its officers of the financial condition of each maker of such obligations is reasonably adequate, and upon certification by an officer of the bank designated for that purpose by the board of directors of the bank, that the responsibility of each maker of such obligations has been evaluated and the bank is relying primarily upon each such maker for the payment of such obligations, the limitations of this section as to the obligations of each such maker shall be the sole applicable loan limitation: *Provided further*, That such certification shall be in writing and shall be retained as part of the records of such bank.

(14) Obligations of the Student Loan Marketing Association shall not be subject to any limitation based upon such capital and surplus.

As amended July 15, 1949, c. 338, Title VI, § 602(b), 63 Stat. 440; July 22, 1937, c. 517, § 15(a), as added Aug. 14, 1946, c. 964, § 5, 60 Stat. 1079, and amended Aug. 25, 1958, Pub.L. 85-748, § 1(c), 72 Stat. 841; Sept. 9, 1959, Pub.L. 86-251, § 3, 73 Stat. 488; Sept. 28, 1962,

Pub.L. 87-723, § 4(c) (4), 76 Stat. 672; May 25, 1967, Pub.L. 90-19, § 27(b), 81 Stat. 29; June 23, 1972, Pub.L. 92-318, Title I, § 133(c) (2), 86 Stat. 270.

§ 93. *Violations of provisions of chapter; forfeiture of franchise; personal liability of directors; civil money penalty*

(a) If the directors of any national banking association shall knowingly violate, or knowingly permit any of the officers, agents, or servants of the association to violate any of the provisions of this chapter, all the rights, privileges, and franchises of the association shall be thereby forfeited. Such violation shall, however, be determined and adjudged by a proper district or Territorial court of the United States in a suit brought for that purpose by the Comptroller of the Currency, in his own name, before the association shall be declared dissolved. And in cases of such violation, every director who participated in or assented to the same shall be held liable in his personal and individual capacity for all damages which the association, its shareholders, or any other person, shall have sustained in consequence of such violation.

(b)(1) Any national banking association which violates, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such association who violates of the provisions of this chapter, or any regulation issued pursuant thereto, shall forfeit and pay a civil money penalty of not more than $1,000 per day for each day during which such violation continues. The penalty shall be assessed and collected by the Comptroller of the Currency by written notice. As used in the section, the term "violates" includes without any limitation any action (alone or with another or others) for or toward causing, bringing

about, participating in, counseling, or aiding or abetting a violation.

(2) In determining the amount of the penalty the Comptroller shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the association or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

(3) The association or person assessed shall be afforded an opportunity for agency hearing, upon request made within ten days after issuance of the notice of assessment. In such hearing all issues shall be determined on the record pursuant to section 554 of Title 5. The agency determination shall be made by final order which may be reviewed only as provided in paragraph (4). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

(4) Any association or person against whom an order imposing a civil money penalty has been entered after agency hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within thirty days from the date of such order, and simultaneously sending a copy of such notice by registered or certified mail to the Comptroller. The Comptroller shall promptly certify and file in such court the record upon which the penalty was imposed, as provided in section 2112 of Title 28. The findings of the Comptroller shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(e) of Title 5.

(5) If any association or person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the agency, the Comptroller shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

(6) The Comptroller may, in his discretion, compromise, modify, or remit any civil money penalty which is subject to imposition or has been imposed under this section.

(7) The Comptroller shall promulgate regulations establishing procedures necessary to implement this subsection.

(8) All penalties collected under authority of this section shall be covered into the Treasury of the United States. As amended Nov. 10, 1978, Pub.L. 95-630, Title I, § 103, 92 Stat. 3643.

§ *1818. Termination of status as insured bank*

Notice by bank of intention; citation of bank for unsound practices or violations; hearings; judicial review

(a) Any insured bank (except a national member bank, a foreign bank having an insured branch which is a Federal branch, a foreign bank having an insured branch which is required to be insured under section 3104(a) or (b) of this title, or State member bank) may, upon not less than ninety days' written notice to the Corporation, terminate its status as an insured bank. Whenever the Board of Directors shall find that an insured bank or its directors or trustees have engaged or are engaging in unsafe or unsound practices in conducting the business of such bank, or is in an unsafe or unsound condition to continue operations as an insured bank, or violated an applicable law, rule, regulation or or-

der, or any condition imposed in writing by the Corporation in connection with the granting of any application or other request by the bank, or any written agreement entered into with the Corporation, the Board of Directors shall first give to the Comptroller of the Currency in the case of a national bank or a district bank, to the authority having supervision of the bank in the case of a State Bank, and to the Board of Governors of the Federal Reserve System in the case of a State member bank, a statement with respect to such practices or violations for the purpose of securing the correction thereof and shall give a copy thereof to the bank. Unless such correction shall be made within one hundred and twenty days, or such shorter period not less than twenty days fixed by the Corporation in any case where the Board of Directors in its discretion has determined that the insurance risk of the Corporation is unduly jeopardized, or fixed by the Comptroller of the Currency in the case of a national bank, or the State authority in the case of a State bank, or Board of Governors of the Federal Reserve System in the case of a State member bank as the case may be, the Board of Directors, if it shall determine to proceed further, shall give to the bank not less than thirty days' written notice of intention to terminate the status of the bank as an insured bank, and shall fix a time and place for a hearing before the Board of Directors or before a person designated by it to conduct such hearing, at which evidence may be produced, and upon such evidence the Board of Directors shall make written findings which shall be conclusive. If the Board of Directors shall find that any unsafe or unsound practice or condition or violation specified in such statement has been established and has not been corrected within the time above prescribed in which to make such corrections, the Board of Directors may order that the insured status of the bank be terminated on a date subsequent to such finding

and to the expiration of the time specified in such notice of intention. Unless the bank shall appear at the hearing by a duly authorized representative, it shall be deemed to have consented to the termination of its status as an insured bank and termination of such status thereupon may be ordered. Any insured bank whose insured status has been terminated by order of the Board of Directors under this subsection shall have the right of judicial review of such order only to the same extent as provided for the review of orders under subsection (h) of this section. The Corporation may publish notice of such termination and the bank shall give notice of such termination to each of its depositors at his last address of record on the books of the bank, in such manner and at such time as the Board of Directors may find to be necessary and may order for the protection of depositors. After the termination of the insured status of any bank under the provisions of this subsection, the insured deposits of each depositor in the bank on the date of such termination, less all subsequent withdrawals from any deposits of such depositor, shall continue for a period of two years to be insured, and the bank shall continue to pay to the Corporation assessments as in the case of an insured bank during such period. No additions to any such deposits and no new deposits in such bank made after the date of such termination shall be insured by the Corporation, and the bank shall not advertise or hold itself out as having insured deposits unless in the same connection it shall also state with equal prominence that such additions to deposits and new deposits made after such date are not so insured. Such bank shall, in all other respects, be subject to the duties and obligations of an insured bank for the period of two years from the date of such termination, and in the event that such bank shall be closed on account of inability to meet the demands of

its depositors within such period of two years, the Corporation shall have the same powers and rights with respect to such bank as in case of an insured bank.

Cease-and-desist proceedings

(b)(1) If, in the opinion of the appropriate Federal banking agency, any insured bank, bank which has insured deposits, or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such a bank is engaging or has engaged, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to engage, in an unsafe or unsound practice in conducting the business of such bank, or is violating or has violated, or the agency has reasonable cause to believe that the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank is about to violate, a law, rule, or regulation, or any condition imposed in writing by the agency in connection with the granting of any application or other request by the bank or any written agreement entered into with the agency, the agency may issue and serve upon the bank or such director, officer, employee, agent, or other person a notice of charges in respect thereof. The notice shall contain a statement of the facts constituting the alleged violation or violations or the unsafe or unsound practice or practices, and shall fix a time and place at which a hearing will be held to determine whether an order to cease and desist therefrom should issue against the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after service of such notice unless an earlier or a later date is set by the

agency at the request of any party so served. Unless the party or parties so served shall appear at the hearing personally or by a duly authorized representative, they shall be deemed to have consented to the issuance of the cease-and-desist order. In the event of such consent, or if upon the record made at any such hearing, the agency shall find that any violation or unsafe or unsound practice specified in the notice of charges has been established, the agency may issue and serve upon the bank or the director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank an order to cease and desist from any such violation or practice. Such order may, by provisions which may be mandatory or otherwise, require the bank or its director, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation or practice.

(2) A cease-and-desist order shall become effective at the expiration of thirty days after the service of such order upon the bank or other person concerned (except in the case of a cease-and-desist order issued upon consent, which shall become effective at the time specified therein), and shall remain effective and enforceable as provided therein, except to such extent as it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

(3) This subsection and subsections (c) through (f) and (h) through (n) of this section shall apply to any bank holding company, and to any subsidiary (other than a bank) of a bank holding company, as those terms are defined in the Bank Holding Company Act of 1956, and to any organization organized and operated under section 25A of the Federal Reserve Act or operating under section 25 of the Federal Reserve Act, in the same manner as they apply to

a State member insured bank. Nothing in this subsection or in subsection (c) of this section shall authorize any Federal banking agency, other than the Board of Governors of the Federal Reserve System, to issue a notice of charges or cease-and-desist order against a bank holding company or any subsidiary thereof (other than a bank or subsidiary of that bank).

(4) This subsection and subsections (c), (d), (h), (i), (k), (*l*), (m), and (n) of this section shall apply to any foreign bank or company to which subsection (a) of section 3106 of this title applies and to any subsidiary (other than a bank) of any such foreign bank or company in the same manner as they apply to bank holding company and any subsidiary thereof (other than a bank) under subparagraph (3) of this subsection. For the purposes of this subparagraph, the term ''subsidiary'' shall have the meaning assigned to it in section 2 of the Bank Holding Company Act of 1956.

Temporary cease-and-desist orders

(c)(1) Whenever the appropriate Federal banking agency shall determine that the violation or threatened violation or the unsafe or unsound practice or practices, specified in the notice of charges served upon the bank or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank pursuant to paragraph (1) of subsection (b) of this section, or the continuation thereof, is likely to cause insolvency or substantial dissipation of assets or earnings of the bank, or is likely to seriously weaken the condition of the bank or otherwise seriously prejudice the interests of its depositors prior to the completion of the proceedings conducted pursuant to paragraph (1) of subsection (b) of this section, the agency may issue a temporary order requiring the bank or such director, officer, employee, agent, or other person to cease and desist

from any such violation or practice and to take affirmative action to prevent such insolvency, dissipation, condition, or prejudice pending completion of such proceedings. Such order shall become effective upon service upon the bank or such director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank and, unless set aside, limited, or suspended by a court in proceedings authorized by paragraph (2) of this subsection, shall remain effective and enforceable pending the completion of the administrative proceedings pursuant to such notice and until such time as the agency shall dismiss the charges specified in such notice, or if a cease-and-desist order is issued against the bank or such director, officer, employee, agent, or other person, until the effective date of such order.

(2) Within ten days after the bank concerned or any director, officer, employee, agent, or other person participating in the conduct of the affairs of such bank has been served with a temporary cease-and-desist order, the bank or such director, officer, employee, agent, or other person may apply to the United States district court for the judicial district in which the home office of the bank is located, or the United States District Court for the District of Columbia, for an injunction[1] setting aside, limiting, or suspending the enforcement, operation, or effectiveness of such order pending the completion of the administrative proceedings pursuant to the notice of charges served upon the bank or such director, officer, employee, agent, or other person under paragraph (1) of subsection (b) of this section, and such court shall have jurisdiction to issue such injunction.

Temporary cease-and-desist orders; enforcement

(d) In case of violation or threatened violation of, or failure to obey, a temporary cease-and-desist order issued pursuant to paragraph (1) of subsection (c) of this section,

the appropriate Federal banking agency may apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the bank is located, for an injunction to enforce such order, and, if the court shall determine that there has been such violation or threatened violation or failure to obey, it shall be the duty of the court to issue such injunction.

Suspension or removal of director or officer

(e)(1) Whenever, in the opinion of the appropriate Federal banking agency, any director or officer of an insured bank has committed any violation of law, rule, or regulation or of a cease-and-desist order which has become final, or has engaged or participated in any unsafe or unsound practice in connection with the bank, or has committed or engaged in any act, omission, or practice which constitutes a breach of his fiduciary duty as such director or officer, and the agency determines that the bank has suffered or will probably suffer substantial financial loss or other damage or that the interests of its depositors could be seriously prejudiced by reason of such violation or practice or breach of fiduciary duty or that the director or officer[2] has received financial gain by reason of such violation or practice or breach of fiduciary duty, and that such violation or practice or breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer, or one which demonstrates a willful or continuing disregard for the safety or soundness of the bank, the agency may serve upon such director or officer a written notice of its intention to remove him from office.

(2) Whenever, in the opinion of the appropriate Federal banking agency, any director or officer of an insured bank, by conduct or practice with respect to another insured bank or other business institution which resulted in substantial

financial loss or other damage, has evidenced either his personal dishonesty or a willful or continuing disregard for its safety and soundness, and, in addition, has evidenced his unfitness to continue as a director or officer and, whenever, in the opinion of the appropriate Federal banking agency, any other person participating in the conduct of the affairs of an insured bank, by conduct or practice with respect to such bank or other insured bank or other business institution which resulted in substantial financial loss or other damage, has evidenced either his personal dishonesty or a willful or continuing disregard for its safety and soundness, and, in addition, has evidenced his unfitness to participate in the conduct of the affairs of such insured bank, the agency may serve upon such director, officer, or other person a written notice of its intention to remove him from office or to prohibit his further participation in any manner in the conduct of the affairs of the bank.

(3) In respect to any director or officer of an insured bank or any other person referred to in paragraph (1) or (2) of this subsection, the appropriate Federal banking agency may, if it deems it necessary for the protection of the bank or the interests of its depositors, by written notice to such effect served upon such director, officer, or other person, suspend him from office or prohibit him from further participation in any manner in the conduct of the affairs of the bank. Such suspension or prohibition shall become effective upon service of such notice and, unless stayed by a court in proceedings authorized by subsection (f) of this section, shall remain in effect pending the completion of the administrative proceedings pursuant to the notice served under paragraph (1) or (2) of this subsection and until such time as the agency shall dismiss the charges specified in such notice, or, if an order of removal or prohibition is issued against the director or officer or other person, until

the effective date of any such order. Copies of any such notice shall also be served upon the bank of which he is a director or officer or in the conduct of whose affairs he has participated.

(4) A notice of intention to remove a director, officer, or other person from office or to prohibit his participation in the conduct of the affairs of an insured bank, shall contain a statement of the facts constituting grounds therefor, and shall fix a time and place at which a hearing will be held thereon. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after the date of service of such notice, unless an earlier or a later date is set by the agency at the request of (A) such director or officer or other person, and for good cause shown, or (B) the Attorney General of the United States. Unless such director, officer, or other person shall appear at the hearing in person or by a duly authorized representative, he shall be deemed to have consented to the issuance of an order of such removal or prohibition. In the event of such consent, or if upon the record made at any such hearing the agency shall find that any of the grounds specified in such notice have been established, the agency may issue such orders of suspension or removal from office, or prohibition from participation in the conduct of the affairs of the bank, as it may deem appropriate. In any action brought under this section by the Comptroller of the Currency in respect to any director, officer or other person with respect to a national banking association or a District bank, the findings and conclusions of the Administrative Law Judge shall be certified to the Board of Governors of the Federal Reserve System for the determination of whether any order shall issue. Any such order shall become effective at the expiration of thirty days after service upon such bank and the director, officer, or other person concerned (except in the

case of an order issued upon consent, which shall become effective at the time specified therein). Such order shall remain effective and enforceable except to such extent as it is stayed, modified, terminated, or set aside by action of the agency or a reviewing court.

(5) For the purpose of enforcing any law, rule, regulation, or cease-and-desist order in connection with an interlocking relationship, the term "officer" as used in this subsection means an employee or officer with management functions, and the term "director" includes an advisory or honorary director, a trustee of a bank under the control of trustees, or any person who has a representative or nominee serving in any such capacity.

Stay of suspension and/or
prohibition of director or officer

(f) Within ten days after any director, officer, or other person has been suspended from office and/or prohibited from participation in the conduct of the affairs of an insured bank under subsection (e)(5) or (e)(7) of this section, such director, officer, or other person may apply to the United States district court for the judicial district in which the home office of the bank is located, or the United States District Court for the District of Columbia, for a stay of such suspension and/or prohibition pending the completion of the administrative proceedings pursuant to the notice served upon such director, officer, or other person under subsection (e)(1), (e)(3), or (e)(7) of this section, and such court shall have jurisdiction to stay such suspension and/or prohibition.

Suspension or removal of director or
officer charged with felony

(g)(1) Whenever any director or officer of an insured bank, or other person participating in the conduct of the affairs of such bank, is charged in any information, indict-

ment, or complant authorized by a United States attorney, with the commission of or participation in a crime involving dishonesty or breach of trust which is punishable by imprisonment for a term exceeding one year under State or Federal law, the appropriate Federal banking agency may, if continued service or participation by the individual may pose a threat to the interests of the bank's depositors or may threaten to impair public confidence in the bank, by written notice served upon such director, officer, or other person, suspend him from office or prohibit him from further participation in any manner in the conduct of the affairs of the bank. A copy of such notice shall also be served upon the bank. Such suspension or prohibition shall remain in effect until such information, indictment, or complaint is finally disposed of or until terminated by the agency. In the event that a judgment of conviction with respect to such crime is entered against such director, officer, or other person, and at such time as such judgment is not subject to further appellate review, the agency may, if continued service or participation by the individual may pose a threat to the interests of the bank's depositors or may threaten to impair public confidence in the bank, issue and serve upon such director, officer, or other person an order removing him from office or prohibiting him from further participation in any manner in the conduct of the affairs of the bank except with the consent of the appropriate agency. A copy of such order shall also be served upon such bank, whereupon such director or officer shall cease to be a director or officer of such bank. A finding of not guilty or other disposition of the charge shall not preclude the agency from thereafter instituting proceedings to remove such director, officer, or other person from office or to prohibit further participation in bank affairs, pursuant to paragraph (1), (2), or (3) of subsection (e) of this section. Any notice of suspension or

order of removal issued under this paragraph shall remain effective and outstanding until the completion of any hearing or appeal authorized under paragraph (3) hereof unless terminated by the agency.

(2) If at any time, because of the suspension of one or more directors pursuant to this section, there shall be on the board of directors of a national bank less than a quorum of directors not so suspended, all powers and functions vested in or exercisable by such board shall vest in and be exercisable by the director or directors on the board not so suspended, until such time as there shall be a quorum of the board of directors. In the event all of the directors of a national bank are suspended pursuant to this section, the Comptroller of the Currency shall appoint persons to serve temporarily as directors in their place and stead pending the termination of such suspensions, or until such time as those who have been suspended, cease to be directors of the bank and their respective successors take office.

(3) Within thirty days from service of any notice of suspension or order of removal issued pursuant to paragraph (1) of this subsection, the director, officer, or other person concerned may request in writing an opportunity to appear before the agency to show that the continued service to or participation in the conduct of the affairs of the bank by such individual does not, or is not likely to, pose a threat to the interests of the bank. Upon receipt of any such request, the appropriate Federal banking agency shall fix a time (not more than thirty days after receipt of such request, unless extended at the request of the concerned director, officer, or other person) and place at which the director, officer, or other person may appear, personally or through counsel, before one or more members of the agency or designated employees of the agency to submit written materials (or, at the discretion of the agency, oral testimony) and oral

argument. Within sixty days of such hearing, the agency shall notify the director, officer, or other person whether the suspension or prohibition from participation in any manner in the conduct of the affairs of the bank will be continued, terminated, or otherwise modified, or whether the order removing said director, officer or other person from office or prohibiting such individual from further participation in any manner in the conduct of the affairs of the bank will be rescinded or otherwise modified. Such notification shall contain a statement of the basis for the agency's decision, if adverse to the director, officer or other person. The Federal banking agencies are authorized to prescribe such rules as may be necessary to effectuate the purposes of this subsection.

Hearings and judicial review

(h)(1) Any hearing provided for in this section (other than the hearing provided for in subsection (g)(3) of this section) shall be held in the Federal judicial district or in the territory in which the home office of the bank is located unless the party afforded the hearing consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of Title 5. Such hearing shall be private, unless the appropriate Federal banking agency, in its discretion, after fully considering the views of the party afforded the hearing, determines that a public hearing is necessary to protect the public interest. After such hearing, and within ninety days after the appropriate Federal banking agency or Board of Governors of the Federal Reserve System has notified the parties that the case has been submitted to it for final decision, it shall render its decision (which shall include findings of fact upon which its decision is predicated) and shall issue and serve upon each party to the proceeding an order or orders consistent with the provisions

of this section. Judicial review of any such order shall be exclusively as provided in this subsection (h). Unless a petition for review is timely filed in a court of appeals of the United States, as hereinafter provided in paragraph (2) of this subsection, and thereafter until the record in the proceeding has been filed as so provided, the issuing agency may at any time, upon such notice and in such manner as it shall deem proper,j modify, terminate, or set aside any such order. Upon such filing of the record, the agency may modify, terminate, or set aside any such order with permission of the court.

(2) Any party to the proceeding, or any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order served pursuant to paragraph (1) of this subsection (other than an order issued with the consent of the bank or the director or officer or other person concerned, or an order issued under paragraph (1) of subsection (g) of this section) by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit, within thirty days after the date of service of such order, a written petition praying that the order of the agency be modifed, terminated, or set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the agency, and thereupon the agency shall file in the court the record in the proceeding, as provided in section 2112 of Title 28. Upon the filing of such petition, such court shall have jurisdiction, which upon the filing of the record shall except as provided in the last sentence of said paragraph (1) be exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the agency. Review of such proceedings shall be had as provided in chapter 7 of Title

5. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari, as provided in section 1254 of Title 28.

(3) The commencement of proceedings for judicial review under paragraph (2) of this subsection shall not, unless specifically ordered by the court, operate as a stay of any order issued by the agency.

Jurisdiction and enforcement; penalty

(i)(1) The appropriate Federal banking agency may in its discretion apply to the United States district court, or the United States court of any territory, within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

(2)(i) Any insured bank which violates or any officer, director, employee, agent, or other person participating in the conduct of the affairs of such a bank who violates the terms of any order which has become final and was issued pursuant to subsection (b) or (c) of this section, shall forfeit and pay a civil penalty of not more than $1,000 per day for each day during which such violation continues. The penalty shall be assessed and collected by the appropriate Federal banking agency by written notice. As used in this section, the term ''violates'' includes without any limitation any action (alone or with another or others) for or toward caus-

ing, bringing about, participating in, counseling, or aiding or abetting a violation.

(ii) In determining the amount of the penalty the appropriate Federal banking agency shall take into account the appropriateness of the penalty with respect to the size of financial resources and good faith of the insured bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require.

(iii) The insured bank or person assessed shall be afforded an opportunity for agency hearing, upon request made within ten days after issuance of the notice of assessment. In such hearing all issues shall be determined on the record pursuant to section 554 of Title 5. The agency determination shall be made by final order which may be reviewed only as provided in subparagraph (iv). If no hearing is requested as herein provided, the assessment shall constitute a final and unappealable order.

(iv) Any insured bank or person against whom an order imposing a civil money penalty has been entered after agency hearing under this section may obtain review by the United States court of appeals for the circuit in which the home office of the insured bank is located, or the United States Court of Appeals for the District of Columbia Circuit, by filing a notice of appeal in such court within ten days from the date of such order, and simultaneously sending a copy of such notice by registered or certified mail to the appropriate Federal banking agency. The agency shall promptly certify and file in such Court the record upon which the penalty was imposed, as provided in section 2112 of Title 28. The findings of the agency shall be set aside if found to be unsupported by substantial evidence as provided by section 706(2)(E) of Title 5.

(v) If any insured bank or person fails to pay an assessment after it has become a final and unappealable order, or after the court of appeals has entered final judgment in favor of the agency, the agency shall refer the matter to the Attorney General, who shall recover the amount assessed by action in the appropriate United States district court. In such action, the validity and appropriateness of the final order imposing the penalty shall not be subject to review.

(vi) Each Federal banking agency shall promulgate regulations establishing procedures necessary to implement this paragraph.

(vii) All penalties collected under authority of this section shall be covered into the Treasury of the United States.

Penalties

(j) Any director or officer, or former director or officer of an insured bank, or any other person, against whom there is outstanding and effective any notice or order (which is an order which has become final) served upon such director, officer, or other person under subsections (e)(3), (e)(4), or (g) of this section, and who (i) participates in any manner in the conduct of the affairs of the bank involved, or directly or indirectly solicits or procures, or transfers or attempts to transfer, or votes or attempts to vote, any proxies, consents, or authorizations in respect of any voting rights in such bank, or (ii) without the prior written approval of the appropriate Federal banking agency, votes for a director, serves or acts as a director, officer, or employee of any bank, shall upon conviction be fined not more than $5,000 or imprisoned for not more than one year, or both.

Definitions

(k) As used in this section (1) the terms ''cease-and-desist order which has become final'' and ''order which has become final'' mean a cease-and-desist order, or an order,

issued by the appropriate Federal banking agency with the consent of the bank or the director or officer or other person concerned, or with respect to which no petition for review of the action of the agency has been filed and perfected in a court of appeals as specified in paragraph (2) of subsection (h) of this section, or with respect to which the action of the court in which said petition is so filed is not subject to further review by the Supreme Court of the United States in proceedings provided for in said paragraph, or an order issued under paragraph (1) or (3) of subsection (g) of this section, and (2) the term "violation" includes without limitation any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.

Notice of service

(l) Any service required or authorized to be made by the appropriate Federal banking agency under this section may be made by registered mail, or in such other manner reasonably calculated to give actual notice as the agency may by regulation or otherwise provide. Copies of any notice or order served by the agency upon any State bank or any director or officer thereof or other person participating in the conduct of its affairs, pursuant to the provisions of this section, shall also be sent to the appropriate State supervisory authority.

Notice to State authorities

(m) In connection with any proceeding under subsection (b), (c)(1), or (e) of this section involving an insured State bank or any director or officer or other person participating in the conduct of its affairs, the appropriate Federal banking agency shall provide the appropriate State supervisory authority with notice of the agency's intent to institute such a proceeding and the grounds therefor. Unless within such

time as the Federal banking agency deems appropriate in the light of the circumstances of the case (which time must be specified in the notice prescribed in the preceding sentence) satisfactory corrective action is effecuated by action of the State supervisory authority, the agency may proceed as provided in this section. No bank or other party who is the subject of any notice or order issued by the agency under this section shall have standing to raise the requirements of this subsection as ground for attacking the validity of any such notice or order.

Ancillary provisions; subpena power, etc.

(n) In the course of or in connection with any proceeding under this section, or in connection with any claim for insured deposits or any examination or investigation under section 1820(c) of this title, the agency conducting the proceeding, examination, or investigation or considering the claim for insured deposits, or any member or designated representative thereof, including any person designated to conduct any hearing under this section, shall have the power to administer oaths and affirmations, to take or cause to be taken depositions, and to issue, revoke, quash, or modify subpenas and subpenas duces tecum; and such agency is empowered to make rules and regulations with respect to any such proceedings, claims, examinations, or investigations. The attendance of witnesses and the production of documents provided for in this subsection may be required from any place in any State or in any territory or other place subject to the jurisdiction of the United States at any designated place where such proceeding is being conducted. Any such agency or any party to proceedings under this section may apply to the United States District Court for the District of Columbia, or the United States district court for the judicial district or the United States court in any

territory in which such proceeding is being conducted, or where the witness resides or carries on business, for enforcement of any subpena or subpena duces tecum issued pursuant to this subsection, and such courts shall have jurisdiction and power to order and require compliance therewith. Witnesses subpenaed under this subsection shall be paid the same fees and mileage that are paid witnesses in the district courts of the United States. Any court having jurisdiction of any proceeding instituted under this section by an insured bank or a director or officer thereof, may allow to any such party such reasonable expenses and attorneys' fees as it deems just and proper; and such expenses and fees shall be paid by the bank or from its assets. Any person who willfully shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in such person's power so to do, in obedience to the subpoena of the appropriate Federal banking agency, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year or both.

Termination of membership of State bank in Federal Reserve System

(o) Whenever the insured status of a State member bank shall be terminated by action of the Board of Directors, the Board of Governors of the Federal Reserve System shall terminate its membership in the Federal Reserve System in accordance with the provisions of subchapter VIII of chapter 3 of this title, and whenever the insured status of a national member bank shall be so terminated the Comptroller of the Currency shall appoint a receiver for the bank, which shall be the Corporation. Except as provided in subsection (b)

of section 1814 of this title, whenever a member bank shall cease to be a member of the Federal Reserve System, its status as an insured bank shall, without notice or other action by the board of directors, terminate on the date the bank shall cease to be a member of the Federal Reserve System, with like effect as if its insured status had been terminated on said date by the board of directors after proceedings under subsection (a) of this section.

Banks not receiving deposits

(p) Notwithstanding any other provision of law, whenever the Board of Directors shall determine that an insured banking institution is not engaged in the business of receiving deposits, other than trust funds as herein defined, the Corporation shall notify the banking institution that its insured status will terminate at the expiration of the first full seminannual assessment period following such notice. A finding by the Board of Directors that a banking institution is not engaged in the business of receiving deposits, other than such trust funds, shall be conclusive. The Board of Directors shall prescribe the notice to be given by the banking institution of such termination and the Corporation may publish notice thereof. Upon the termination of the insured status of any such banking institution, its deposits shall thereupon cease to be insured and the banking institution shall thereafter be relieved of all future obligations to the Corporation, including the obligation to pay future assessments.

Assumption of liabilities

(q) Whenever the liabilities of an insured bank for deposits shall have been assumed by another insured bank or banks, whether by way of merger, consolidation, or other statutory assumption, or pursuant to contract (1) the insured status of the bank whose liabilities are so assumed shall

terminate on the date of receipt by the Corporation of satisfactory evidence of such assumption; (2) the separate insurance of all deposits so assumed shall terminate at the end of six months from the date such assumption takes effect or, in the case of any time deposit, the earliest maturity date after the six-month period; and (3) the assuming or resulting bank shall give notice of such assumption to each of the depositors of the bank whose liabilities are so assumed within thirty days after such assumption takes effect. Where the deposits of an insured bank are assumed by a newly insured bank, the bank whose deposits are assumed shall not be required to pay any assessment upon the deposits which have been so assumed after the seminannual period in which the assumption takes effect.

Action or proceeding against foreign bank; basis; removal of officer or other person; venue; service of process

(r)(1) Except as otherwise specifically provided in this section, the provisions of this section shall be applied to foreign banks in accordance with this subsection.

(2) An act or practice outside the United States on the part of a foreign bank or any officer, director, employee, or agent thereof[3] may not constitute the basis for any action by any officer or agency of the United States under this secction, unless —

(A) such officer or agency alleges a belief that such act or practice has been, is, or is likely to be a cause of or carried on in connection with or in furtherance of an act or practice within any one or more States which, in and of itself, would constitute an appropriate basis for action by a Federal officer or agency under this section; or

(B) the alleged act or practice is one which, if proven, would, in the judgment of the Board of Di-

rectors, adversely affect the insurance risk assumed by the Corporation.

(3) In any case in which any action or proceeding is brought pursuant to an allegation under paragraph (2) of this subsection for the suspension or removal of any officer, director, or other person associated with a foreign bank, and such person fails to appear promptly as a party to such action or proceeding and to comply with any effective order or judgment therein, any failure by the foreign bank to secure his removal from any office he holds in such bank and from any further participation in its affairs shall, in and of itself, constitute grounds for termination of the insurance of the deposits in any branch of the bank.

(4) Where the venue of any judicial or administrative proceeding under this section is to be determined by reference to the location of the home office of a bank, the venue of such a proceeding with respect to a foreign bank having one or more branches or agencies in not more than one judicial district or other relevant jurisdiction shall be within such jurisdiction. Where such a bank has branches or agencies in more than one such jurisdiction, the venue shall be in the jurisdiction within which the branch or branches or agency or agencies involved in the proceeding are located, and if there is more than one such jurisdiction, the venue shall be proper in any such jurisdiction in which the proceeding is brought or to which it may appropriately be transferred.

(5) Any service required or authorized to be made on a foreign bank may be made on any branch or agency located within any State, but if such service is in connection with an action or proceeding involving one or more branches or one or more agencies located in any State, service shall be made on at least one branch or agency so involved.

Sept. 21, 1950, c. 967, § 2[8], 64 Stat. 879; Oct. 16, 1966, Publ.L. 89-695, Title II, §§ 202, 204, 80 Stat. 1046, 1054; Oct. 28, 1974, Pub.L. 93-495, Title I, § 110, 88 Stat. 1506; Sept. 17, 1978, Publ.L. 95-369, §§ 6(c)(14), (15), 11, 92 Stat. 618, 624; Nov. 10, 1978, Publ.L. 95-630, Title I, §§ 107(a)(1), (b), (c)(1), (d)(1), (e)(1), 111(a), Title II, § 208(a), Title III, §§ 303, 304, 92 Stat. 3649, 3653, 3654, 3656, 3660, 3665, 3674, 3676.

COMBINING LOANS TO SEPARATE BORROWERS

§ *7.1310 Loans to corporations and their subsidiaries.*

(a) *Law — 12 U.S.C. 84.*

The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus funds. The term "obligations" * * * shall include in the case of obligations of a copartnership or association the obligations of the several members thereof and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest. * * *

(b) *Purpose.* The section is intended to prevent one individual, or a relatively small group, from borrowing an unduly large amount of the bank's deposits for the use of the particular business enterprises in which they are engaged. It is intended to safeguard the bank's depositors by spreading the loans among a relatively large number of persons engaged in different lines of business.

(c) *General rules.* (1) Obligations of a parent corporation shall be combined with obligations of all subsidiary

corporations in which the parent owns or controls a majority interest.

(2) If the parent corporation is not borrowing, obligations of subsidiary corporations are generally not combined except in the following situations:

(i) Bank is looking to a single source for repayment of the loan.

(ii) One or more loans is for the accommodation of the parent corporation or other subsidiary.

(iii) The borrowing corporations are not separate concerns in reality but merely departments or divisions of a single enterprise.

(3) Obligations of a corporation must be combined with any other extension of credit the proceeds of which are used for the benefit of the corporation.

§ *631. Declaration of policy*

(a) The essence of the American economic system of private enterprise is free competition. Only through full and free competiton can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government (including but not limited to contracts for maintenance, repair, and construction) be placed with small-

business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the over-all economy of the Nation.

(b) It is the declared policy of the Congress that the Government, through the Small Business Administration, should aid and assist small business concerns which are engaged in the production of food and fiber, ranching, and raising of livestock, aquaculture, and all other farming and agricultural related industries; and the financial assistance programs authorized by this chapter are also to be used to assist such concerns.

(c)(1) The assistance programs authorized by sections 636(i) and 636(j) of this title are to be utilized to assist in the establishment, preservation, and strengthening of small business concerns and improve the managerial skills employed in such enterprises, with special attention to small business concerns (1) located in urban or rural areas with high proportions of unemployed or low-income individuals; or (2) owned by low-income individuals; and to mobilize for these objectives private as well as public managerial skills and resources.

(2)(A) With respect to the programs authorized by section 636(j) of this title, the Congress finds—

(i) that ownership and control of productive capital is concentrated in the economy of the United States and certain groups, therefore, own and control little productive capital;

(ii) that certain groups in the United States own and control little productive capital because they have limited opportunities for small business ownership;

(iii) that the broadening of small business ownership among groups that presently own and control little productive capital is essential to provide for the well-

being of this Nation by promoting their increased participation in the free enterprise system of the United States;

(iv) that such development of business ownership among groups that presently own and control little productive capital will be greatly facilitated through the creation of a small business ownership development program, which shall provide services, including, but not limited to, financial, management, and technical assistance.

(v) that the power to let sole source Federal contracts pursuant to section 637(a) of this title can be an effective procurement assistance tool for development of business ownership among groups that own and control little productive capital; and

(vi) that the procurement authority under section 637(a) of this title shall be used only as a tool for a developing business ownership among groups that own and control little productive capital.

(B) It is, therefore, the purpose of the programs authorized by section 636(j) of this title to—

(i) foster business ownership by individuals in groups that own and control little productive capital; and

(ii) promote the competitive viability of such firms by creating a small business and capital ownership development program to provide such available financial, technical, and management assistance as may be necessary.

(d) Further, it is the declared policy of the Congress that the Government should aid and assist victims of floods and other catastrophes, and small-business concerns which are displaced as a result of federally aided construction programs.

(e)(1) with respect to the Administration's business development programs the Congress finds—

(A) that the opportunity for full participation in our free enterprise system by socially and economically disadvantaged persons is essential if we are to obtain social and economic equality for such persons and improve the functioning of our national economy;

(B) that many such persons are socially disadvantaged because of their identification as members of certain groups that have suffered the effects of discriminatory practices or similar invidious circumstances over which they have no control;

(C) that such groups include, but are not limited to, Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities;

(D) that it is in the national interest to expeditiously ameliorate the conditions of socially and economically disadvantaged groups;

(E) that such conditions can be improved by providing the maximum practicable opportunity for the development of small business concerns owned by members of socially and economically disadvantaged groups;

(F) that such development can be materially advanced through the procurement by the United States of articles, equipment, supplies, services, materials, and construction work from such concerns; and

(G) that such procurements also benefit the United States by encouraging the expansion of suppliers for such procurements, thereby encouraging competition among such suppliers and promoting economy in such procurements.

(2) It is, therefore, the purpose of section 637(a) of this title to—

(A) foster business ownership by individuals who are both socially and economically disadvantaged;

(B) promote the competitive viability of such firms by providing such available contract, financial, technical, and management assistance as may be necessary; and

(C) clarify and expand the program for the procurement by the United States of articles, equipment, supplies, services, materials, and construction work from small business concerns owned by socially and economically disadvantaged individuals.

As amended Pub.L. 94-305, Title I, § 112(a), June 4, 1976, 90 Stat. 667; Pub.L. 95-507, Title II, §§ 201, 203, Oct. 24, 1978, 92 Stat. 1760, 1763; Pub.L. 96-302, Title I, § 118(a), July 2, 1980, 94 Stat. 840.

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No. 82-734

In the Supreme Court of the United States

OCTOBER TERM, 1982

TIRSO DEL JUNCO, ET AL., PETITIONERS

v.

C. T. CONOVER, COMPTROLLER OF THE CURRENCY, DEPARTMENT OF THE TREASURY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Comptroller of the Currency's determination that petitioners, directors of a national bank, knowingly approved loans in excess of the bank's legal lending limit is supported by substantial evidence.

2. Whether the Comptroller of the Currency exceeded his statutory authority by ordering directors to indemnify a national bank for the entire amount of illegal loans, without any reduction reflecting recoveries by the bank against the debtor, except insofar as those recoveries exceed the amount of an earlier, lawful, loan to the debtor that remains outstanding.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-12) is reported at 682 F.2d 1338. The decision of the Comptroller of the Currency (Pet. App. 33-52), the accompanying Order to Cease and Desist (Pet. App. 53-55), and the Opinion and Recommended Decision of the Administrative Law Judge (Pet. App. 13-32) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1982. The petition for a writ of certiorari was filed on October 28, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The pertinent facts are fully stated in the decision of the Comptroller of the Currency (Pet. App. 34-40) and are summarized in the court of appeals' opinion (*id.* at 1-4). Briefly, petitioners are the directors of the Los Angeles National Bank ("the Bank"). On two separate occasions petitioners, having full knowledge of all relevant facts, approved the making of loans in excess of the Bank's lending limit established by 12 U.S.C. 84.[1] On January 19, 1979, the Bank made an unsecured loan of $225,000 to Rehbock Lewis, president of Fame Furniture, Inc. ("Fame"). Petitioners knew that the proceeds of this loan were to be used for the benefit of Fame. Four months later, the Bank made a second loan of $225,000, this time directly to Fame. Fame's aggre-

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[1] As of the date of the transactions in controversy, 12 U.S.C. 84 provided in pertinent part:

> The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund.

Section 84 has recently been amended to increase the lending limit established to 15% of the capital base, and to allow extension of additional credit in an amount up to 10% of the capital base where that amount is properly collateralized. Pub. L. No. 97-320, Section 401(a), 96 Stat. 1508.

gate line of credit based upon the two loans was more than $177,000 over the legal limit. Yet, one month later, the Bank made a third loan, in the amount of $125,000, to Ralph Ware, treasurer of Fame, which petitioners knew was for the benefit of Fame. The final loan was sought because Fame's checking account with another bank was overdrawn. The loan was made in Ware's name because the Bank's lending officer advised Lewis and Ware that an additional loan to Lewis or Fame would be unlawful. The Bank's lending officer acknowledged that he knew the proceeds of the loan to Lewis would be used for the benefit of Fame, and in fact the proceeds were deposited directly into Fame's corporate checking account. When the third loan was extended the Bank's loans for the benefit of Fame aggregated more than double the sum permitted by law.

2. The foregoing transactions and apparent violations of 12 U.S.C. 84 were uncovered during a routine periodic examination of the Bank by the Comptroller of the Currency. The Comptroller initially requested that the Bank directors who approved the loans in excess of the Section 84 limit indemnify the Bank for any losses resulting therefrom. Upon the directors' refusal to comply, the Comptroller initiated a formal administrative cease and desist proceeding pursuant to 12 U.S.C. (Supp. V) 1818(b). Petitioners acknowledged in the pleadings that the proceeds of the loan to Lewis were for the benefit of Fame. The administrative law judge accordingly ruled that the Lewis and Fame loans were to be aggregated for purposes of 12 U.S.C. 84, see 12 C.F.R. 7.1310(c)(3), and that the latter loan accordingly had been made unlawfully. After an evidentiary hearing disclosing the circumstances in which the loan to Ware had been made, the ALJ made a similar determination respecting that loan.

The Comptroller adopted the ALJ's findings respecting the unlawful extensions of credit (Pet. App. 34-40). The Comptroller observed that because the cease and desist order based upon a violation of 12 U.S.C. 84 was sought through administrative proceedings under 12 U.S.C. (Supp. V) 1818(b), rather than in district court pursuant to 12 U.S.C. (Supp. V) 93, it was not necessary to establish a "knowing" violation of Section 84, as is required under Section 93. The Comptroller added, however, that if such a showing were necessary, it had been made, because the petitioners knew the amount of the various loans, knew that each loan was made for the use of Fame, and knew that the loans, if aggregated, exceeded the Bank's loan limits (Pet. App. 39-41)

In framing a remedial order pursuant to 12 U.S.C. (Supp. V) 1818(b)(1),[2] the Comptroller concluded that no part of the funds recovered on the unlawful loans by the Bank should be applied to reduce the liability of the directors until the earlier lawful loan to Lewis for the benefit of Fame had been satisfied (Pet. App. 41-49). The ALJ had recommended that the proceeds of the sale of bonds owned by Lewis that had been pledged to secure the illegal loan to Ware, and a balance in Fame's checking account with the Bank, be set off against the directors' liabil-

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[2] 12 U.S.C. (Supp. V) 1818(b)(1) provides in pertinent part that when the record of the administrative proceeding establishes a violation of any banking law or regulation, the banking regulatory agency vested with jurisdiction may issue an order

> requir[ing] the bank or its directors, officers, employees, agents, and other persons participating in the conduct of the affairs of such bank to cease and desist from the same, and, further, to take affirmative action to correct the conditions resulting from any such violation * * *.

ities on the Ware and Fame loans (*id.* at 25-28).[3] The Comptroller rejected this portion of the ALJ's recommendation, noting (*id.* at 43) that the fiduciary relationship between the Bank and its directors, the subject of this proceeding, was not governed by the rules applicable to the contractual relationship between the Bank and its borrowers (compare note 3, *supra*).[4] The Comptroller observed that 12 U.S.C. (Supp. V) 1818(b)(1) authorizes him to require "affirmative action [by directors] to correct the conditions resulting" from unlawful banking practices, and that the "conditions" resulting from the illegal loans in this case include all of the injurious consequences to the Bank of the illegal loans (Pet. App. 41). By making the illegal loans to Fame and Ware for the benefit of Fame, the Comptroller stated, petitioners not only subjected the Bank to risk of loss on those loans, but, as a practical matter, substantially undercut the security of the earlier legal loan to Lewis for the benefit of his company (*id.* at 46-48). Accordingly, the Comptroller deemed it appropriate

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[3] As between the Bank and the borrowers these assets had been applied to repay the Ware loan in its entirety and to reduce the outstanding balance on the Fame loan. The ALJ stated that the bonds and checking account proceeds could not be applied by the Bank to discharge the loan to Lewis, and reasoned that the directors' liabilities to the Bank accordingly had to be reduced to reflect the partial payment of the illegal loans (Pet. App. 26-28).

[4] The Comptroller assumed that the ALJ was correct in suggesting (see note 3, *supra*) that as between the Bank and its borrowers Fame's corporate checking account balance could be applied only against the illegal Fame loan, and the proceeds of the sale of Lewis' bonds pledged as collateral for the Ware loan had to be applied first to discharge that loan (Pet. App. 43).

to apply recoveries from the borrowers to reduce petitioners' liabilities only to the extent that they exceeded the amount due on the initial lawful loan to Lewis. The Comptroller explained (Pet. App. 48-49; citations omitted):

> This approach avoids promoting a conflict between the Directors' fiduciary duty and the best interest of the Bank, since the Board is encouraged to maximize recoveries on an excessive line of credit without regard to whether a particular recovery would be applied to a legal or illegal loan. This approach also avoids rewarding the Directors for their dilatory tactics in refusing to make the Bank whole and is consistent with national bank director responsibilities generally.

The Comptroller rejected petitioners' contention that the remedy prescribed was contrary to certain language in *Corsicana National Bank* v. *Johnson*, 251 U.S. 68, 87 (1919), which, petitioners claimed, required that the Bank's recoveries on the illegal loans be applied to reduce their liabilities in respect of those loans. The Comptroller remarked (Pet. App. 44 n.5):

> While it is true that the court observed, at 251 U.S. 87, that "whatever of value the Bank recovered from the borrowers on account of the loan would go in diminution of damages . . .," the observation related to a single loan, not to a series of loans with the first credit extension being legal. In other words, this case did not address the question of whether recoveries should be applied to reduce directors' liability on an excessive loan while an earlier, lawful loan to the same borrowers remains unpaid.

Although petitioners were potentially liable for the entire amount of the two unlawful loans ($350,000, plus interest due thereon), see *Corsicana National Bank* v. *Johnson*, *supra*, they were actually held liable only for the difference between their total potential liability and the amount recovered by the Bank in excess of the amount due on the initial lawful loan to Lewis (Pet. App. 49). To ensure that petitioners received the benefit of any additional recoveries on the outstanding balance due to the Bank, the Comptroller directed that, upon payment by petitioners of the indemnity required by his order, the Bank was to transfer its interest in the Fame-related loans to petitioners (*id.* at 51, 55).

3. The court of appeals affirmed the Comptroller's decision and upheld the remedial order (Pet. App. 1-12). The court initially held (*id.* at 5-6) that the Comptroller's findings that all of the loans were made for the benefit of Fame (and thus were to be aggregated for purposes of 12 U.S.C. 84) were supported by substantial evidence. The court assumed arguendo that a prerequisite to entry of a remedial order under 12 U.S.C. (Supp. V) 1818(b) is establishment of a "knowing" violation of 12 U.S.C. 84, such as is required in an action in district court under 12 U.S.C. (Supp. V) 93. The court concluded that any scienter requirement had been satisfied, however, because petitioners were shown to have "knowledge of the identity of the borrowers, knowledge that all the loan proceeds were to be used by one company, and knowledge of the loan amounts and the bank's loan limits" (Pet. App. 8).

The court of appeals also upheld the Comptroller's remedial order, rejecting petitioners' argument that the recoveries applied to the illegal loans by the Bank

must be similarly applied to reduce their liabilities to the Bank (Pet. App. 9-11). Underscoring the Comptroller's broad discretion under 12 U.S.C. (Supp. V) 1818(b) to fashion an appropriate remedy, the court of appeals noted that the policy of 12 U.S.C. 84—protection of a bank's assets—would be frustrated if directors were permitted to escape liability for risk of loss imposed upon a bank when directors make lawful unsecured loans to a borrower, followed by further unlawful extensions of credit secured by the borrower's assets. The court explained that "relief" tailored in the manner suggested by petitioners (Pet. App. 10):

> would permit the Directors to protect themselves fully against any exposure resulting from the illegal loans while substantially increasing the risk that the bank would be unable to recover the amount of its legal loan. The fiduciary responsibility of the Directors of the bank precludes them from protecting themselves against liability at the bank's expense. * * * Thus, the Directors may not use the borrower's assets to extinguish their own liability to the bank.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or of any other court of appeals. The opinions of the court of appeals and the Comptroller of the Currency, upon which we rely, fully and persuasively answer the contentions advanced in the petition. Further review of the decision in this case is accordingly unwarranted.

1. Petitioners initially contend that the decision of the court of appeals is at odds with decisions of this Court (*Corsicana National Bank* v. *Johnson*,

supra, 251 U.S. at 71-72; *Yates* v. *Jones National Bank*, 206 U.S. 158, 178, 180 (1907)) holding that a knowing violation of the credit limits established by 12 U.S.C. 84 must be proven in an action under 12 U.S.C. (Supp. V) 93 to recover damages from a national bank director. But, as the court of appeals observed (Pet. App. 7), the liabilities imposed upon petitioners do not rest upon Section 93, derived from the National Bank Act of 1864, which on its face applies only to knowing violations, but upon provisions of 12 U.S.C. (Supp. V) 1818(b)(1), enacted in 1966 and supplemented in 1978, that do not require any such showing. Without qualification Section 1818(b)(1) allows the Comptroller to require "affirmative action to correct the conditions resulting from" any banking law violation. See page 4 note 2, *supra*. Accordingly, petitioners' reliance upon cases construing Section 93 is entirely misplaced. Significantly, petitioners do not, and cannot, claim that the court of appeals' decision conflicts with any decision of this Court or of any other court respecting 12 U.S.C. (Supp. V) 1818(b)(1).

In any event, the court of appeals, the Comptroller, and the ALJ all correctly determined that, if applicable, the scienter requirement of Section 93 was satisfied in this case (see Pet. App. 7-9, 23-25, 40-41). The court of appeals concluded (*id.* at 5-6, 8) that substantial evidence supported the Comptroller's determination that petitioners had knowledge of all pertinent facts establishing a violation of 12 U.S.C. 84—the identity of the borrowers, the intended use of all three loans for the benefit of one borrower, the amounts of the loans, and the Bank's loan limits.[5]

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[5] Petitioners mischaracterize the court of appeals' decision as holding that "[p]etitioners intentionally violated Section

Petitioners' contrary assertion (Pet. 9) impermissibly asks this Court to re-examine the court of appeals' assessment of the substantial evidence question. *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 310 (1974); *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 491 (1951).

Moreover, petitioners have identified no evidence to support their assertion.[6] Given the findings of the Comptroller upheld by the court of appeals, petitioners' explanation that "at the time they approved each loan [they] believed [that] the loans did not exceed the lending limits of the bank" (Pet. 8) is unavailing. Because petitioners were found to have had knowledge of all the facts establishing a violation of 12 U.S.C. 84, petitioners' contention must be understood as either ignorance of the law or a failure to appreciate the significance of the facts known to them. Neither theory affords any recognized defense to petitioners.

2. Petitioners also contend (Pet. 9-13) that the Comptroller's remedial order, prohibiting application of the borrowers' assets to reduce petitioners' liability upon the unlawful loans until recoveries from the borrowers exceed the amount due to the Bank on the initial unsecured but lawful loan to Lewis, is inconsistent with *Corsicana National Bank* v. *Johnson*,

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84" (Pet. 5; see also Pet. 7). As described above, the court of appeals actually concluded that substantial evidence supported the Comptroller's findings of knowing violations (Pet. App. 7-9). As early as *Thomas* v. *Taylor*, 224 U.S. 73, 82 (1912), this Court rejected the view that director liability under 12 U.S.C. (Supp. V) 93 must rest upon a finding of an intentional violation.

[6] Indeed, petitioners' own answer to the Comptroller's notice of charges (see Pet. App. 36-38) provides substantial evidence supporting the Comptroller's findings.

supra, 251 U.S. at 87. But, as the opinion of the Comptroller explains (see Pet. App. 44 & n.5), *Corsicana National Bank* simply does not address the situation presented here (see page 6, *supra*).

In addition, as we have noted, *Corsicana National Bank* sheds no light upon the proper interpretation of the Comptroller's subsequently enacted authority under 12 U.S.C. (Supp. V) 1818(b)(1) to shape an appropriate remedial order. As the court of appeals observed (Pet. App. 10), this grant of authority is broad and unqualified. Petitioners have not attempted to identify any error in the Comptroller's determination, endorsed by the court of appeals, that in the circumstances of this case, a remedial order tailored as petitioners suggest would not meet the statutory standard; that is, such an order would not "correct the conditions" resulting from petitioners' unlawful extension of credit. See 12 U.S.C. (Supp. V) 1818(b)(1).[7]

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[7] We note that the Comptroller's apprehension that the Bank might suffer unless petitioners were held accountable for their maladministration of the Bank's assets is not at all speculative upon the facts of this case, because the corporate borrower, Fame, entered bankruptcy shortly after the loans in question here were made (see Pet. App. 48). Indeed, even at the time the final loan of the series at issue was made to Ware, Fame's checking account with another bank was overdrawn (Pet. App. 5). Of course, should the borrowers ultimately make good upon all their debts, petitioners, who stand in the shoes of the Bank under the Comptroller's remedial order, will suffer no loss.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Petitioners,

vs.

C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

PETITIONERS' REPLY BRIEF.

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No. 82-734

IN THE

Supreme Court of the United States

October Term, 1982

TIRSO DEL JUNCO, WALTER L. RASIC, ANDRES ALONZO, JR., C.V. HOLDER, MARTIN CASTILLO, GRACE C. QUINN, ANTONIO E. VALLE, GILBERT R. VASQUES, HAL W. BROWN, JR.,

Petitioners,

vs.

C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

PETITIONERS' REPLY BRIEF.

Respondent, in his opposing brief, raises for the first time an issue mentioned but not decided by the Ninth Circuit. Respondent claims the legislative history of 12 USC (Supp. V) Section 1818(b)(i) ("Section 1818") and the relevant case law, do not indicate a Congressional intent to incorporate the 12 USC Section 93 ("Section 93") "intentional violation" standard into Section 1818 proceedings. Accordingly, Respondent argues Petitioners' reliance on cases, such as *Corsicana National Bank v. Johnson*, 251 U.S. 68 (1919), which construe Section 93, is misplaced. (Brief in Opp. p. 9)

Respondent ignores a basic rule of statutory interpretation which provides that where a statute has been judicially con-

strued for a period of sufficient duration to provide Congress with adequate opportunities to modify the statute and it has not done so, congressional inaction or silence in this context is persuasive evidence of its satisfaction with the judicial interpretation of the statute, especially when Congress has amended the statute in other respects. [*Missouri v. Ross*, 299 U.S. 72, 75 (1936); *United States v. Elgin, J. & E. R. Co.*, 298 U.S. 492, 500 (1935).]

Since 1907 it has been established, that before personal liability may be imposed on a director for the damages caused by a violation of the National Bank Act which includes 12 USC section 84 (''Section 84'') and Section 93, it must be established that the director intentionally or knowingly violated the statute. The establishment of mere negligence is not sufficient.

> ''. . . [T]he statute imposes certain express duties and makes a knowing violation of such commands the test of civil liability, the oath in this regard also conforms to the requirements of the statute by the promise not to 'knowingly violate, or willingly permit to be violated, any of the provisions of this title'. . . . [W]here by law a responsibility is made to arise from the violation of a statute knowingly, proof of something more than negligence is required; that is, that the violation must in effect be intentional. . . .''
>
> *Yates v. Jones National Bank*, 206 U.S. 158, 176-180 (1907).[1]

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[1]See also: *Bailey v. Babcock*, 241 F. 501 (1915); *McCormick v. King*, 241 F. 737 (1917); *Curtis v. Metcalf*, 265 F. 293 (1918); *First Nat. Bank of Fairbanks v. Noyes*, 257 F. 593 (1919); *Gamble v. Brown*, 29 F. 2d 366 (1928); *Ringeon v. Albinson*, 35 F. 2d 753 (1929); *Payne v. Ostrus*, 50 F. 2d 1039 (1931); *Anderson v. Akers*, 9 F. Supp. 151 (1934); *Deitrick v. Ames*, 24 F. Supp. 1 (1938); *Stein v. Galitz*, 478 F. Supp. 517 (1978); 11 ALR Fed. 606.

In 1978 Congress had an opportunity to change this interpretation when it amended Section 93 by dividing it into Sections (a) and (b) and also amended Section 1818. However, Congress did not change any of Section 93's original language but did add some new remedies that were not previously available to Respondent, such as the assessment of civil money penalties. (For legislative history and purpose of 1978 amendment of Sections 93 and 1818 see 1978 U.S. Code Cong. and Adm. News p. 9273.) By not changing any of the original language of Section 93 Congress may be deemed to be satisfied with the established judicial interpretation of the relationship between Sections 84 and 93 cited above even with respect to Section 1818 proceedings. (*Missouri v. Ross, supra.; United States v. Elgin, J. & E. R. Co., supra.*)

Another applicable rule of statutory interpretations states.

> "[T]he construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong, especially when Congress has refused to alter the administrative construction. Here, the Congress has not just kept its silence by refusing to overturn the administrative construction, but has ratified it with positive legislation. . . ."
>
> *Red Lion Broadcasting Co. v. F.C.C.*, 395 U.S. 367, 381-382 (1969).

In previous Section 1818 proceedings brought by Respondent against other directors of other national banking associations, Respondent has consistently asserted that Section 93 applies in such proceedings when directors are required by a cease and desist order to indemnify a bank for loans which violate Section 84. Respondent made this disclosure in an offer of proof filed in response to the Administrative

Law Judge's ("ALJ") request for copies of previous cease and desist orders and agreements.

Even though a court has never decided this issue of whether Section 93 applies to Section 1818, when one considers the legislative and administrative history of these three sections it is evident that Congress and Respondent both acknowledge that Section 93 applies to a Section 1818 proceeding. Accordingly, reliance on cases construing Section 93, such as *Corsicana*, is not misplaced. Rather these cases temper Respondent's desire to extend the scope of his remedial powers beyond what was contemplated by Congress in enacting Sections 93 and 1818; they also establish what the appropriate remedial order should have been in this case: one which limits Petitioners' liability to the unpaid balance of the two illegal loans.

The importance and substantiality of the questions presented in the petition have not been denied by Respondent. Further, since this Court has never addressed itself to the relationship between Sections 1818, 84 and 93 (including the cases interpreting those sections) there are compelling reasons why some definitive guidelines in the application of Section 1818's remedial powers should now be established by this Court, especially with regard to the extent to which those powers may be used to alter national bank directors' personal liability for excess loans.

Respectfully submitted,

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of IVERSON, YOAKUM, PAPIANO
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